

DELHI UNIVERSITY
LIBRARY

DELHI UNIVERSITY LIBRARY

Cl. No X61 H71

Ac No T950 Date of release for loan

This book should be returned on or before the date last stamped below An overdue charge of 5 Paise will be collected for each day the book is kept overtime.

THE MEANING OF MONEY

BY THE SAME AUTHOR

THE MEANING OF MONEY.
STOCKS AND SHARES.
MONEY CHANGING.
WAR AND LOMBARD STREET.
POVERTY AND WASTE.
INTERNATIONAL FINANCE.
THE BUSINESS OF FINANCE.
WAR-TIME FINANCIAL PROBLEMS.
OUR MONEY AND THE STATE.

Edited by HARTLEY WITHERS.

LOMBARD STREET A Description of the Money Market. By WALTER BAGEHOT.

THE MEANING OF MONEY

HARTLEY WITHERS

"Grau, theurer Freund, ist alle Theorie
Und grün des Lebens goldner Baum."
GOETHE.

"The principles of banking are dynamic and not static, and will have to be developed and frequently modified."
MR. MONTAGU NORMAN,
in Evidence before the Indian Currency Commission.

LONDON
JOHN MURRAY, ALBEMARLE STREET, W.

First Edition (*Smith, Elder & Co.*) . . *1909*
Second Edition *1909*
Third Edition *1909*
Fourth Edition *1916*
Seventeenth Impression (*John Murray*) . *1918*
Twenty-seventh Impression *1928*
Fifth Edition *1930*
Reprinted *1930*
Reprinted *1932*
Sixth Edition *1937*
Reprinted *1945*
Seventh Edition *1947*
Reprinted *1948*

Made and Printed in Great Britain by Butler & Tanner Ltd., Frome and London

CONTENTS

PAGE

CHAPTER I

INTRODUCTORY 1

Different senses in which the word money is used—The money of daily payments and the money of the money market—In the latter sense, money means the loan of money—The money market is the place where money is borrowed: and most of its business consists in giving money down for the promise of money some day—It also gives money here for money somewhere else, through exchange operations

CHAPTER II

COINED CASH 7

Gold, silver, and bronze—Gold the most potent, and why—Barter—The kine currency; its defects in contrast with the advantages of the gold piece—The comparative steadiness of the value of gold—Its universal acceptability in economically civilized communities—The disappearance of the sovereign—Gold still needed as backing for paper money—Its value now largely conventional—Legal tender—Silver coin

CHAPTER III

PAPER CASH 17

Gold economized by the circulation of bank-notes, or bankers' promises to pay—Currency based on mutual indebtedness between bankers and the public—Unfortunate results of faulty working of the system—Its regulation by law, in the Bank Act of

PAGE

sense and the rate of interest ruling—London and Sydney—London and Paris—Foreign exchanges the mechanism for the settlement of international indebtedness—How this indebtedness arises—Balance settled by gold shipments, modified by finance bills—Effect on exchanges of purchase and sale of securities—Loan issues—Italy's purchases of its own debt—The rate of discount and the exchanges —The Exchange Equalization Fund.

CHAPTER XI

THE BANK OF ENGLAND 163

Keeper of the nation's balance—Privilege of note issue—The bankers' bank—Provides emergency currency, Peel's Act having been evaded by the use of cheques, based on credits in the Bank's books—Keeper of the gold reserve—An expensive responsibility—The external problem—Foreign demands created by credits given by the other banks—Summary of the Bank's functions—Its organization—Court of Directors—Revolutionary changes in recent years

CHAPTER XII

BANK RATE AND MARKET RATE 182

What Bank rate means—Formerly seldom effective in normal times—Connexion now established between Bank rate and market rate—Why the market has to be regulated—The Bank's power over the market—Handling Treasury Bills—The hidden hand—Closer personal touch—"Open market policy"

CHAPTER XIII

THE BANK RETURN 198

A specimen of its form—1908 and 1936—The Issue Department—The fiduciary issue—The metallic basis; silver in the Issue Department—The Bank's capital—The Rest—The Public and Other deposits —The bankers' balances now shown separately—New Light on the assets side—The cryptogram and the key—The Reserve

PAGE

CHAPTER XIV

THE GOLD STANDARD 220

The change in the problem—Internal developments —The rise of America—The chorus of critics—A *Punch* cartoon—England's Return to Gold—At the Old Parity—The Fall of the Pound—Devaluation now Fashionable—What do we want?—The effect of price movements—Stability desirable—The Quantity theory of money—Its truth and limits

CHAPTER XV

A NEW MONETARY WORLD 241

An Old Problem in a New Form—Present-Day Advantages—Convertibility Abandoned—But Gold Stock still Necessary—Flexible Fiduciary Note Issue—Caution Needed in its Use—The Exchange Equalization Fund—Its Limits as a Safeguard—Control of Security Market, Alleged rather than Effective—Increased Prestige, Monetary and Political—Other Possible Controls—Applied Intelligence—Present-Day Disadvantages—"Hot Money" —Widespread Speculation—Ignorance of Business Shown by Monetary Authorities—Sensitiveness of Public's Nerves—Justified by Prevalent Uncertainties

CHAPTER XVI

SUMMARY AND CONCLUSION 267

CHAPTER XVII

THE FALL OF THE POUND 270

America's collapse—Her leadership—Its devastating effects—The Hitler election—The run on Germany —The death of the gold standard—Its working by England—Banking weaknesses in America—The run on England—The May Report—Efforts to save the pound—The Naval "Mutiny"—The British public's calm—Industrial recovery—America cuts gold value of dollar—England's default on debt to America

PAGE

CHAPTER XVIII

THE WARTIME BULGE 286

The Bank of England's growth—The Clearing Banks' bulge—The Discount Houses' capital increase—Stock Exchange restriction—Capital Issues Committee—Cheap war finance—Treasury deposit receipts—Bank of England nationalization—"Information and Instructions"—National Savings—Two new companies

CHAPTER XIX

PEACE-TIME PROBLEMS 298

A simplified interval—An Exchange Equalization Fund—The American credit—Its terms and conditions—Their possible consequences—Mutual concessions?—United States Department of Commerce Report—Need for great effort in England—Can we do it?—London's advantage—The Coal Crisis—Its causes—Mr. Hobson's survey—Mr. Usborne on Coal into Oil—Possible improvement in Agriculture—Women's work available—Benefits of Improved Education—Increase of output all over the world—Britain chief external market for most of it—Advantage of debtor's position—Incentive necessary

INDEX 317

PREFACE TO THE SEVENTH EDITION

IN the Sixth Edition the progress of the Money Market was traced up to 1929, nearly to the death of the gold standard, already modified by two Acts of Parliament, and attacked by critics, some of them of high authority. Since then the " fall of the pound " and the nationalization of the Bank of England have produced changes, more apparent than real, in the picture. Money is still what it always has been, anything that is accepted in payment; and its progress from cowry shells, tobacco and other popular commodities, to gold, bank-notes, bills of exchange and cheques has made little difference to the problems surrounding its acquisition and handling.

In fact, it is more than ever plain that the use made of money is far more important than the technical details of its market. If all nations and all their citizens, or an effective majority of them, could be taught or otherwise induced to treat one another like good neighbours, economic problems would very easily solve themselves; and it is encouraging to note that in this country the present fuel crisis and its consequent difficulties and inconveniences have produced a notable increase in the kindliness and consideration shown by most members of the crowds, as I, in my eightieth year, have often experienced.

I hope that my readers may exercise the same indul-

gence for a writer working under the drawbacks involved by *anno domini*, aggravated by lack of warmth and light, and all the nuisances of this abnormally prolonged winter.

HARTLEY WITHERS.

5 IVERNA COURT,
LONDON, W.8,
February 22, 1947.

CHAPTER I

INTRODUCTORY

THE meaning of Money is not a question of economic theory. The object of this volume is to explain a matter of plain, positive, practical fact, which is very important, very dull and very little understood; and to do so as clearly as may be, and with the least possible use of the alarming apparatus which generally affrights the casual reader who opens a book on a monetary subject. No columns of statistics will be paraded and deployed, the use of diagrams will be sedulously avoided, and as far as possible figures will be ruled out.

The word Money is associated with much confusion and difficulty in the minds of those who have not been obliged to think the matter out, because of the different senses in which it is used. In one sense it is perfectly simple, without the least reflection or examination. Everybody understands money in the sense of the pounds, shillings, and pence that we pay in the shape of coin, notes or cheques for everyday wants. But the other most common use of the word leads to complications, because in its second sense money means not money, but the loan of money.

This is the sense in which the word is used when we speak of a money market or a price of money, phrases which are wholly incomprehensible to those to whom

this difference of meaning is not made clear. Anyone who defines money roughly as a pound in his pocket, with which he can buy whatever he wants up to the extent of its purchasing power, does so quite naturally, for this is its most obvious meaning. But having got this meaning into his head, he is unable, and again quite naturally, to understand strange expressions in the newspapers which tell him that money is cheap or that the money market is tight. He knows that the price of a thing is the number of pounds, or fractions of a pound, that it will fetch. He also knows that no one will give him more than a pound for the pound that he has in his pocket, and he is equally convinced that the most cunning sophistries of the most skilful dialectician would never induce him to part with it for less. He therefore proceeds triumphantly to the conclusion that it is nonsense to talk about a price for money, and his argument is perfectly sound on the premises from which he starts.

His mistake arises from the fact that, as has been stated, money is often used in a quite different sense, namely, the loan of money; or perhaps the matter can be made still clearer if we express it by saying that the words "price" and "market" are applied in a different sense when applied to money from their meaning in connexion with any ordinary commodity. The price of a hat is the pound that you pay to become its owner; the price of money is the pound or pounds that you promise to pay some day for the loan or temporary use of it. The market in wool or wheat is the place where you can buy these articles from the assembled merchants or dealers. The money market is the place in which you can borrow money.

It thus becomes apparent that the phrase which has

proved a stumbling-block to so many generations of schoolboys and more mature students—that money is a commodity which can be bought and sold like any other—is not true. Money is certainly a commodity, but it cannot be bought and sold like any other, for that would imply exchanging it for itself, since buying and selling are nothing but the exchange of commodities for money, as distinguished from barter, which is exchanging commodities for one another. Money can be borrowed or lent, and this is at once a perfectly reasonable and comprehensible transaction, which would never cause the least bewilderment in the mind of the most unmathematical schoolboy. It is perfectly clear to Jones, minor, that it might be to his advantage, in the lean and hungry days towards the end of term, to take five shillings in hard cash and to promise to pay seven-and-six after the holidays, when everybody's pocket is bursting with printed or metallic evidences of family affection. And this transaction, allowance being made for local and psychological variations, is a fair specimen of the business done every day in Lombard Street and in the other money markets of the world.

The money market, then, is the place in which money down is exchanged for the promise of money some day. And as the borrower, the man who wants money down, must obviously offer the lender an inducement to let him have it, it will always be found that the amount of money promised some day by the borrower is bigger than the amount of money paid down by the lender. The difference between the two figures is the rate of interest, which is often loosely and confusingly described as the price of money.

This rate of interest, as everyone knows, is calculated

" per cent.," so much on each £100 borrowed. If you borrow £1,000 for a year from your banker, and he charges you 3 per cent., or £3 per £100 for the advance, he will give you the right to draw a cheque now for £1,000, or to withdraw this amount in coin or notes, and at the end of the year you will owe him £1,030. But this simple statement of the matter is complicated slightly in usual practice, because the interest is probably payable periodically at the quarter or half-year. This complication becomes important in the case of loans for long or indefinite periods, but the broad fact remains that the chief operations of the money market consist of giving cash down in return for the promise of a little more cash some day, or of annual or half-yearly cash payments.

Time is thus the distinctive element in the most ordinary and obvious transactions of the money market, and clears away the difficulty which besets those who cannot understand how a money market can exist. To exchange money for money would be absurd; to exchange money now for more money some day is evidently a quite reasonable convenience to a borrower who hopes to make a profitable use of the sum borrowed, and to earn more by its employment than the price that he will have to pay for it. And space is the other element which accounts for the rest of the market's operations. Besides giving and taking money down in return for money some day, it is also engaged in giving and taking money here for money somewhere else. Hence arises the complicated and difficult mechanism of what is generally called " exchange," which also becomes a comparatively simple matter when it is clearly expressed and freed from confusing technicalities. The broad meaning of it is

clear enough, if you reflect that when you buy a postal order you are conducting an exchange transaction. You receive a communication from a tradesman in a town in which you formerly lived to the effect that his account, amounting to five shillings, has been long outstanding, and that he would be glad to have it settled. The five shillings are ready enough in your pocket, but the question is, how to get them for example, from London to Bristol. You can put two half-crowns in an envelope, register it, and so send your money at the cost of 5½*d*. But the cheaper and more convenient method is to pay some one who has money in Bristol something to induce him to pay your debt for you there. That some one is ready in the person of the Post Office, which sells you an order for five shillings, payable at any office in the United Kingdom, for five shillings plus 1½*d*. You put the order in an envelope and send the money at a total cost of fourpence, and your tradesman presents it at the Bristol post office and receives cash. Thus you have carried out an exchange transaction, which may be technically expressed by saying that you have bought a draft on Bristol, and forwarded it to your creditor, and that it has been met on presentation.

Monetary transactions may thus be divided into three main divisions :—

(1) Those in which money is exchanged for any kind of commodity or service ; ordinary buying or selling operations.

(2) Those in which money down is exchanged for the promise of money some day ; these include all kinds of loan operations, from the discounting of a bill due sixty days hence to an issue of a war loan by the British Government.

(3) Those in which money here is exchanged for money somewhere else; and these are exchange operations, which have been crudely exemplified by the purchase of a postal order, but are by far the most complicated kind of monetary business, which is now everywhere more or less regulated by official or semi-official control.

It will be observed that in all three there is one constant factor, which is money here and now, or cash. In ordinary buying and selling cash is exchanged for goods or services, as when we buy a pair of gloves across the counter of a shop, or send a reluctant cheque to pay a dentist's account or a lawyer's bill of costs. In loan operations cash is exchanged for some form of security or promise to pay. In exchange operations cash is exchanged for drafts representing a right to money in some other place. And before we can go any further, it will be necessary to give some explanation of the different forms taken by cash, or money here and now. Everybody knows that when a payment is to be made in England it will take the form of coin, Bank of England notes, or, most probably, a cheque drawn on a banker; and the stages by which these forms of payment came into being are a well-worn story, which must be summarized briefly in the interests of clearness and completeness.

CHAPTER II

COINED CASH

WHEN this book was first written, it said that "the most obvious of the forms of cash is the coined currency that we carry in our pockets, consisting of gold, silver, and bronze discs, stamped with the image and superscription of the King, and milled round the edges to prevent enterprising bullionists from shaving metal off their rims. This precaution, it will be observed, is not considered necessary in the case of the penny. The most potent of these, in extracting goods and services from mankind, is gold."

Since then we have had a great war, and the handsome gold coins of which we used to be so proud have vanished from everyday use. Now we carry Bank of England £1 and 10*s*. notes, introduced at the end of 1928. Until then the lowest denomination of Bank of England notes had been £5, and they were chiefly used as cash reserves by the other banks and were rarely seen in circulation, except on racecourses and in other purlieus frequented by persons whose credit was doubtful. The £1 and 10*s*. notes were created to take the place of the gold coins of pre-war days and of the Treasury notes which had been invented in 1914, when our gold coins "went to the front" and did not come back again.

Though, however, we had ceased to carry gold in

our pockets, the notes that have taken its place were still convertible, on certain conditions, into gold on demand until 1931; since then, this right of conversion has ceased, but nevertheless gold is still regarded as part of the basis of credit in England and in economically civilized countries. And it will help us to understand what money does for us, if we look at the reasons which have raised gold to this position, of an essential support for paper currencies.

Buying is distinguished from barter by being an exchange of goods for money instead of an exchange of goods for goods. The inconvenience of a state of barter is evident on a moment's reflection, and it need not be said that as long as it prevailed commercial progress was almost impossible. The sad state of the hungry hatter, unable, in the days of barter, to get meat because the butcher wants not hats but boots, is a commonplace of the economic text-books, and it is clear at once that a long step forward has been taken when a community agrees to recognize one commodity as always acceptable in payment for others, so that any capitalist who is possessed of a store of it may always rely on being able to convert it into whatever he needs that is produced by his fellows. It is also evident that the commodity selected had to be endowed with certain qualities, chief among which were that it should be always acceptable, lasting, easy to pass from hand to hand, and fairly uniform, that is with not too great a difference in size and desirability between its various examples.

The Old Testament story shows that in the primitive society depicted by it a man's wealth was gauged by the size of his flocks and herds and the number of his changes of raiment, and in the Homeric poems

fine suits of armour are valued by the number of kine that they would fetch. Other instances of the use of articles of common consumption as currency include tobacco, hides, shells, bullets and nails. But the prevalence of beasts was sufficient to lead etymologists to consider at one time that the Latin word for a beast, *pecus*, had been enshrined in the name for money, *pecunia*, which has come down in English in the forms pecuniary and impecunious. This derivation is now abandoned, comparative philology having decided that *pecunia* is the same word as the English "fee," and is chiefly memorable for having prompted a passage, full of vivid fancy and inspiration, in Carlyle's *Sartor Resartus*. "A simple invention it was," says Herr Teufelsdröckh, "in the old-world Grazier—sick of lugging his slow Ox about the country till he got it bartered for corn or oil—to take a piece of Leather, and thereon scratch or stamp the mere Figure of an Ox (or *Pecus*); put it in his pocket, and call it *Pecunia*, Money. Yet hereby did Barter grow Sale, the Leather Money is now Golden and Paper, and all miracles have been out-miracled: for there are Rothschilds and English National Debts; and whoso has sixpence is sovereign (to the length of sixpence) over all men; commands Cooks to feed him, Philosophers to teach him, Kings to mount guard over him —to the length of sixpence."

The ox was certainly at one time a standard of value, though it may be doubted whether it passed generally as currency, even stamped on leather, for Carlyle's hypothesis really requires a rather advanced stage of credit organization, with token money issued by graziers, and apparently accepted by a trusting and economically civilized public. But in any case

the ox must have been singularly ill-adapted for currency purposes; its acceptability cannot have been nearly as general as that of gold, craved for by human vanity for purposes of decoration; not only was it not lasting, but it was certain to deteriorate after a certain age, and finally to perish; it was very far from portable, as Carlyle's Grazier found; and the difference between one ox and another in size, value, and other respects is so great that the kine circulation must have been singularly liable to the action of the great economic principle known as Gresham's Law, under which, as we shall see later, bad currency drives out good.

All this has been somewhat laboriously set forth, because in these respects the ox is the very antithesis of the gold-piece, and having seen wherein the ox failed, we have already grasped the advantages of the sovereign.

The sovereign was permanent,[1] portable, and of universal acceptability, either in its own shape or melted back into its original bullion. As it emerged from the Mint, there was no appreciable difference between it and its fellows, and its long use as the standard money of the leading commercial nation had given it a position which was unrivalled at the beginning of the century and unparalleled in the past. The different experiences to which one sovereign and another might be subjected made a difference to the length of time during which they preserved their full weight, but weight rarely became a question of practi-

[1] Comparatively permanent, that is. It was not wholly impervious to wear and tear, and M. de Launay, in his work on *The World's Gold*, estimated that a gold coin would entirely disappear in eight thousand years.

cal importance to holders of the sovereign considered as cash, though it was always watched carefully by bullion dealers, who regarded the sovereign merely as a piece of gold that might be melted into bars. The coinage was so well cared for that for purposes of inland and retail exchange one might be taken to be as good as another, as long as we were certain that it was a real sovereign, duly stamped and milled. We were apt to take this inestimable convenience as a matter of course, but it was only secured by constant vigilance on the part of the responsible authorities, and throughout the Middle Ages untold loss, inconvenience and uncertainty was caused by the chronically chaotic state of the currency in this and other countries.

In those good old days, monarchs who did not actually debase their own currencies by decreasing the amount of true metal in them, and then passing them to their unsuspecting subjects, were regarded as enlightened and disinterested reformers; and the imperfect methods of coinage employed even by the best-intentioned made it easy to sweat and clip the coins, that is to say, to shave bits off them, and then pass them on. Here came in the opportunity of the bullion dealer, and the process arose which went on undetected for centuries until it was enounced and denounced by Sir Thomas Gresham, Queen Elizabeth's great monetary adviser, who stated his famous economic law on the subject. The gist of which is, that if two coins are in circulation, one better than the other, the good one will be held back by anyone who is wise enough to recognize its merits, and the bad one will be passed on; so that after a time only the clipped and sweated coins will be circulating in the hands of the public, and the full-weighted ones will be either

in the vaults of the bullion dealers or melted into bars. To protect themselves against the working of this law, our forefathers used sometimes to carry a small pair of scales, with weights representing a guinea and a half-guinea, fitted into a neat case to be tucked into the pocket.

It has been claimed for gold, that one of its great advantages, which helped to raise it to its position of predominance as circulating medium and basis of credit, is its steadiness in value. It was, in fact, a common delusion that the value of gold is fixed and never varies. The value of gold appeared to be fixed by the law which compelled the Mint to take any gold that was brought to it and coin it into sovereigns at the rate of £3 17*s.* 10½*d.* per oz., but that was only another way of expressing the fact that a coined sovereign was equivalent to so much gold; but because we were accustomed to value everything in sovereigns many of us were led into the assumption that gold which could always be made into so many sovereigns per oz. must therefore be unchangeable in value. But if we keep fast hold of the fact that the value of a thing is what it will fetch, it will be seen at once that the sovereign or the gold from which it was coined, had no such charmed prerogative. When wheat was 35*s.* a quarter the buying power of the sovereign, in the pocket of the miller who wanted to buy wheat, was different from its value when wheat was 25*s.* But though *the value of gold can be no more fixed than that of* anything else, at the same time its comparative indestructibility, and the enormous amount of it in existence in one shape or another, make its value depend much less than that of most other things on the amount of the output at the moment.

Wheat, which is grown to be consumed straightway, depends for its price on the prospects of the present crop and the amount left over of the last; gold, which is mined in order to be kept in the form of plate, ornaments, coins and ingots, and is rarely abolished by consumption, is obviously much less dependent on the chances which may be tending to increase its amount more or less rapidly than usual. For whatever its form, it may always be brought out and melted, and so come into the market in the shape of cash, as was recognized by the prudent Athenians[1] when in the days of their prosperity they overlaid the statue of Athene with gold, giving it a gorgeous appearance for the time being and leaving a reserve which could at any time be stripped off and turned into the sinews of war. Gold thus may be regarded as less likely to fluctuate in value than most other commodities owing to the huge accumulated supply, which renders the new output for the time being a matter of comparatively little importance; and this fact, which has sometimes been exaggerated into a statement that its value is fixed, certainly contributed with its beauty as decoration and its commanding merits as currency, to the universal acceptability of gold, in economically civilized countries, in payment for goods and services.

After the war, we could not afford a gold currency. Our gold had to be all, or practically all, in the shop-window, that is in the vaults of the Bank of England, and the jolly old Yellow Boys, that used to make a tip from an uncle an artistic joy as well as a practical gain, were seen no more. The prestige of the British sovereign, welcomed all over the world, was passed

[1] Thucydides, ii. 13.

on first to the Treasury note and then to the £1 Bank of England note, and the need for gold as money has ceased to be apparent to the man in the street.

But though we did not see gold in the after-war period it was still the foundation of our currency and credit system, because, as will be shown later, every bank-note that was issued above a certain limit had to have a gold backing behind it. The need for this gold backing was questioned not only by the large number of people who still think that everyone can be made happy by pouring out fresh supplies of money, and forget that what we live on is not money but goods and services, but also by high economic authorities on high scientific grounds. They argued that stability in prices is all-important, and that it would be easier to secure it if we no longer based our currency on gold, but regulated its amount so as to prevent fluctuations in the prices of commodities. This theory, together with the Quantity Theory of Money with which it is closely connected, will be examined later. At this point in our investigation it is enough to say that the only money which can do its work, of giving its holder the power to buy what he wants, is money that will everywhere be taken in payment. "How full of briars is this working-day world," says Rosalind, and it is just as full, and fuller, of conventions and prejudices. Owing to the hold that gold has won over the mind of the trading community, for the reasons shown above, paper money is still regarded with more confidence when it has a substantial backing of gold behind it; and we shall see when we come to examine the causes and effects of the collapse of the gold standard, that the Bank of England made enormous additions to its

gold stock, when it was no longer under any obligation to convert its notes into gold.

How long this convention which gives so much of its value to gold will last, is a question that will also have to be considered. Here, it need only be noted that gold was originally valued chiefly for purposes of decoration, and that this real and practical value helped it to become the chief form of money, by giving it general acceptability; but as its amount has grown, its use as money, and backing for money, has so greatly exceeded its use as decoration (now reinforced by dentistry), that its value now rests almost entirely on this purely conventional craving for it, based on habit and conservatism, and the mistrust felt by most people for money manipulated by Governments.

The small change that we carry in our purses need not detain us long. It must be noted that silver or, since 1947, cupro-nickel coins are not "legal tender" to the extent of more than £2; that is to say, if you owe your tailor £5, you cannot legally satisfy the debt by handing him one hundred shillings or any other arrangement in silver. Probably it would not occur to you to do so, and if you did he would probably accept it, and the restriction is not apparently of much practical importance. Actually it is most important, for the dreary record of currency history is a long tale of the uncertainty and inconvenience which arose in the days when people tried to keep gold and silver circulating on equal terms at a fixed ratio, with the result that the one which happened for the moment to be less valuable as bullion continually drove out of circulation the one which was more valuable, thanks to the operation of Gresham's Law and the quick and cunning bullion merchants. Bimetallists maintained

that the confusion and difficulty of the two-metal system only arose because it was not scientifically and universally applied, and Bimetallism has been endorsed by eminent theoretical authority. The simplicity of the single standard, however, has obvious practical advantages, and it may at least be claimed that England, by making silver legal tender only up to sums of £2, and adopting what is called a gold standard, solved a problem which had puzzled the civilized world for centuries.

It may be also observed that our silver coins were mere tokens; that is to say, they did not pretend to contain as much of the metal as would, if melted down, fetch as much as the value at which they circulate.

Bronze coins are legal tender only to the extent of one shilling.

CHAPTER III

PAPER CASH

THE exchange of a hat for a sovereign was a quite commonplace proceeding, but when we began to exchange a hat for a piece of paper, which was only accepted because it was believed to be convertible into gold, the element of belief, that is to say of credit, entered into the transaction, and we had moved up a step on the ladder of economic civilization.

The first stage, as we have seen, was from barter, by which goods were exchanged for goods, to purchase, by which goods were exchanged for one commodity of universal acceptability. And a process of painful evolution finally decided that gold was best fitted to be that commodity. But an enormous expansion of trade was made possible when it was discovered that gold could be economized by the use of paper which represented and multiplied it, and when confidence in a banker became sufficiently established to induce the community to circulate his promises to pay instead of pieces of metal.

The process of this evolution, also, was painful enough, and the loss and uncertainty caused by the bad and debased coin currency of the Middle Ages were rivalled by the ruin and disasters of the early days of banking, when notes were issued without any

ability of the issuer to meet them on presentation. Nevertheless, the appearance of the bank-note marks the first step in the development of banking as we understand it nowadays, that is, of a machinery for the manufacture of credit.

Before the bank-note won its way into circulation, such bankers as existed were chiefly goldsmiths and bullion dealers; they were sometimes loan mongers, collecting coin from one set of customers to lend it to another, or to discount bills for another, but it was only when they began to induce those who borrowed from them to take the cash advanced in the form of notes that the economy of metal became possible and the wheel of the credit machine began to turn to any purpose. The original goldsmith's note was a receipt for metal deposited. It took the form of a promise to pay metal, and so passed as currency. Some ingenious goldsmith conceived the epoch-making notion of giving notes not only to those who had deposited metal, but to those who came to borrow it, and so founded modern banking.

As long as the bankers took care of coin and ingots for Jones and lent them to Smith, the commercial community was given a certain convenience, by knowing where dealers in money were to be found, but the convenience was severely restricted. When the bankers lent Smith not coin but a promise to pay coin, they soon discovered, since their promise to pay did not at once come back to them for presentation, that in the meantime they might safely accommodate Brown, Robinson and Williams with a similar number of similar promises to pay; and so they hit on the great device by which modern commerce transacts its business by means of evidence of mutual indebtedness

At first sight there is something whimsical in the process of stimulating production and expanding trade by an agreement between two parties to owe one another something; but this agreement is an important part of the structure of the modern edifice of credit.

Let us see it at work in the case of the primitive bank which we are now supposing to be emerging from the bullion-dealing to the note-issuing stage. At first, we supposed it engaged in taking care of metallic money for Smith and lending it to Jones, and its balance-sheet would stand thus, if we leave out its capital for the sake of simplicity:—

Due to Smith . .	£10,000	Loan to Jones . .	£10,000

After it had made the momentous step of inducing Jones to take its notes instead of metal, the balance-sheet would show the following development:—

Due to Smith . .	£10,000	Cash in hand . .	£10,000
Notes outstanding.	10,000	Loan to Jones . .	10,000
Total	£20,000	Total	£20,000

You will observe that since Jones has taken his loan in notes the cash originally deposited by Smith remains in the bank's hands, and the loan to Jones is represented by a liability of the bank to meet the notes which it has passed over to him. These notes, being a promise to pay by the bank, are in effect a loan by Jones to it, and thus Jones and the bank have become mutually indebted. The bank has lent £10,000 to Jones, and he, by taking payment in the bank's promises to pay, is lending it £10,000 as long as he refrains from presenting the notes and demanding cash for them. Jones and the bank are thus mutually in-

money the currency has been increased by £10,000, and to that extent Jones is enabled to hire and load a ship for foreign trade, or otherwise to engage in productive enterprise.

When the bank finds that the notes which Jones borrowed are not quickly presented, but are accepted by the commercial community for the payments that he makes in loading his ship, and passed on from hand to hand and remain outstanding, it proceeds to the next step of making advances to Brown, Robinson and Williams, and the balance-sheet will be amplified as follows :—

Due to Smith . .	£10,000	Cash in hand . .	£10,000
Notes outstanding.	40,000	Loans to customers	40,000
	£50,000		£50,000

The great principle of currency based on mutual indebtedness has thus been extended; the bank is liable for £40,000 of its promises to pay on demand, and its customers are indebted to it for £40,000. And this £40,000 is in circulation, quickening the wheels of trade, increasing production and profitable commerce. And the mutual indebtedness of the bank and its customers has brought this new currency into being.

But it will be observed that the bank now owes £50,000 in all, and holds only £10,000 in metallic cash against all these liabilities on demand. This will probably be a safe proportion for it to work on in ordinary circumstances, but if it continued to increase the amount of its note issue without a proportionate increase in the amount of cash held against it, the day would come when some unforeseen accident brought

its fate would be sealed. In the early days of banking this sort of disaster was common enough, and folk found that they had sold their goods and services in return for notes which they had believed to be as good as gold and discovered too late to be worth only the paper that they were printed on. The manufacture of currency out of mutual indebtedness had proved too easy and simple a process, and the necessity for a proportionate backing of gold had been ignored.

Disasters of this kind not only reduced the number of note-issuing banks in England, but produced a body of opinion which aimed at making the bank-note a mere bullion certificate, only to be issued against a backing of gold to its full value. In London, the Bank of England had, since its very early days, possessed the monopoly of note issue as far as joint-stock companies were concerned, and the private banks had already ceased to issue notes when the question of the regulation of the note issue was taken in hand in 1844.

The body of opinion above referred to then prevailed, and it was decided by the Bank Act of 1844 that in future any expansion in the Bank of England's note circulation must only be based on metal. Up to £14,000,000 it might issue notes against securities, and it was arranged that if any country note issues lapsed, two-thirds of them might be added to the amount of notes that the Bank of England might so issue, and this arrangement had raised the amount of bank-notes based on securities to nearly 20 millions in 1928, when the Currency and Bank Notes Act revised the whole position and provided for the fusion of the Treasury notes—a Government issue which had been created in 1914—with the Bank of England's note

and 10s. notes. Under this Act the Bank of England might issue notes against securities to the extent of £260 millions. This constitutes what is called its "fiduciary," or "confidential" issue. Above that line, every note issued had to be backed by gold. Since, however, the disappearance of gold coins from ordinary use, and the appearance of £1 and 10s. bank-notes as cash in the pockets of the public, made large fluctuations in the circulation of bank-notes much more probable, it was necessary to give greater elasticity to the fiduciary issue. It was accordingly provided by the new Act that the Bank might increase or reduce the amount of the fiduciary issue at any time with the consent of the Treasury; though no increase can be maintained for more than two years without the consent of Parliament. Under the old Act of 1844, the limit on the fiduciary issue could only be exceeded after the Bank had got a promise from the Chancellor of the Exchequer, which was only granted at times of acute crisis, that he would ask Parliament to indemnify the Bank for its breach of the law. The new Act thus provided for its own suspension, if the Bank and the Treasury thought this advisable, by a much simpler and less formidable method than was possible under the statute of 1844.

By the Gold Standard Act of 1925, the right to convert Bank of England notes into gold, which had been suspended after the war, was restored in a modified form. Conversion into sovereigns was not given back to all holders of bank-notes, because the country clearly could not afford the luxury of a gold circulation; though in practice the Bank did give sovereigns for its notes at its discretion. But it was obliged by

in legal tender (which in this case meant bank-notes), at £3 17*s.* 10½*d.* per ounce standard, but only in bars containing approximately 400 fine ounces. Free convertibility of the bank-note for those who wanted gold for export was thus secured, and the golden link was firmly riveted between the English pound and the currencies of other countries that were on the gold standard, or were more or less closely hitched to it. This golden link between the currencies of the chief countries of the world was (we used to think) of great benefit to international trade, by keeping fluctuations in rates of exchange within moderate limits.[1]

Such are the conditions under which Bank of England notes were issued until the autumn of 1931, when we were forced off the gold standard by foreign panic, as will be related later. Since then English money has no longer been convertible into gold, and our abandonment of this principle has been followed by all the leading nations, the process being completed in the autumn of 1936, when the surviving members of the Gold Bloc were driven by force of circumstances into revaluations of their currencies. A stock of gold, however, is still regarded as necessary to economic safety; and we and the United States have both made enormous additions to our gold-heaps, after freeing ourselves from the rigid fetters of the gold standard.

The consideration of the bank-note has thus already taken us over the wavy and very ill-defined line which separates cash from credit. For a bank-note is both. It is cash in that it is legal tender and so must be accepted in payment of a debt, and it is credit in that it is a promise to pay, and has no intrinsic value. Its use, in economizing gold and multiplying the effective-

ness of the gold retained in the hands of the banker, has already been demonstrated, and it has also been recorded that the disasters which followed from its abuse, in days when bankers had not grasped the necessity for keeping an adequate proportion of gold to meet notes presented, and for keeping the rest of their assets liquid and realizable, led to a reaction. This reaction prompted the passing of measures in England which prohibited this economy of gold by means of the bank-note, and laid down that any increase in the Bank of England's issue was to be based on an equal amount of gold in its vaults, each £5 note being actually represented by £5 in gold.

If the apparent intentions of the Act of 1844 had been carried out, the subsequent enormous development of English trade, if it had been possible at all, must have been accompanied by the heaping up of a vast mass of gold in the Bank's vaults. But its intentions were evaded by the commercial community, which had already appreciated the advantages of a currency based on mutual indebtedness between itself and the banks. The commercial community ceased to circulate bank-notes under the new restrictions, developing the use for daily cash transactions of a credit instrument which had already acquired some popularity, namely, a draft or bill on its bankers payable on demand, and now commonly called a cheque. The drawing of cheques was not in any way limited by the Act of 1844, and the cheque was in many ways a more convenient form of currency than the bank-note. For the strength of the Bank of England note was in itself an inconvenience in one respect; since the nature of the note was such that anyone who held

a roll of them in one's pocket was as valuable a burden as so many sovereigns or gold bars, with the additional merit of being more easily carried by the owner and the serious disadvantage of being more easily carried off by anyone else. This danger was avoided or enormously reduced when the community adopted the habit, not of carrying or sending bank-notes, but of drawing a cheque on its bank for every transaction that it wished to complete by payment.

The use of the cheque, however, involves the element of belief to a much greater extent than that of the bank-note. We have seen that the latter is certain of being taken in payment for goods as long as the British Government stands and the Bank of England is solvent, but the exchangeability of the former depends on the solvency of the drawer of the cheque—probably a private individual—and of the bank on which it is drawn. A shopkeeper who takes a cheque in payment for a pair of boots is liable on presenting it through his banker to have it returned marked with ominous signs, which are interpreted to mean that the customer's alleged bank refuses to meet it, because his account is overdrawn, or perhaps because he never had an account with it at all. Or it is barely possible that he may be informed that the bank on which the cheque was drawn has put up its shutters, though this possibility is happily one that need not be practically considered now in England, owing to the stability which centuries of experience and the light of publicity have given to British banking.

But these two risks, one a practical one and the other theoretically in being, make the extensive use of cheques possible only in a community which has

also blessed with a high level of general honesty among its members. And these features in the character of a cheque also made it obviously impossible that it could be given the privilege of legal tender, that is, that anyone could be bound by law to accept a cheque in payment for goods delivered or services rendered. No one could be compelled to take a piece of paper signed by an unknown person and purporting to be an order on a bank of which perhaps he had never heard. So that the cheque has had to fight its way to its present supremacy without this advantage, and to drive gold and notes out of circulation, except in small and special transactions, in spite of the fact that they were legal tender and it was not. This it was enabled to do by its safety and convenience and the power of the drawer, by varying the form in which he makes it out, to hedge it about with safeguarding restrictions, or to leave it convertible into cash by anyone who presents it. A cheque is merely an order on a bank from one of its customers to pay some of the money which it holds on his account to a third party, or to himself if he wants to take out cash. It can be manufactured with a piece of notepaper and a twopenny stamp, but it is much more usual to use one of the well-known regular forms supplied by banks to their customers.

The convenience of the cheque follows from its safety; if bank-notes are being sent, it is necessary to note all the numbers and register the packet; a cheque, protected by being crossed and marked "not negotiable," goes safely in an ordinary envelope. The words "not negotiable" do not make a cheque not negotiable, but their effect is, that no holder of a cheque so marked can pass on a better title to it than

he has himself; consequently, if it is stolen, anyone who takes it from the thief cannot claim on it. Further, the fact that it can be drawn to the exact amount required is a great advantage, and its return to the drawer through his bank, when it has done its work and been cancelled, is an additional convenience, and makes the cheque a record and receipt, as well as a form of payment.

But in considering the qualities of the cheque it must never be forgotten that it is a certificate immediately convertible into legal tender cash, which to-day means Bank of England notes. It need hardly be said that the great majority of cheques are never presented to be turned into cash; they are paid into banks by those who receive them, and crossed off against one another in the Clearing-house, where representatives of all the banks meet and exchange claims against one another; and cheques thus for the most part merely act as indicators in the transactions which result in the daily transfer of an enormous amount of credit from one hand to another, the whole affair being finally reduced to a matter of book-keeping exchanges between the various bankers and between the various accounts in their books. But the fact that every cheque gives the holder, or his bank, the right to demand legal tender from the bank on which it is drawn is highly important; without it, the cheque could not have won its way to general acceptability, and could not be treated as cash, as it is rather heretically treated here, on the ground that it is, in the vast majority of cases, readily accepted in exchange for goods or services in ordinary transactions. And the immediate convertibility into Bank of England notes, which is behind every cheque, means that an adequate

supply of notes to meet them on presentation is as necessary to bankers who supply their customers with cheque-books as an adequate stock of gold was to those who formerly made advances to them in the shape of notes, or promises to pay. In these days when a banker lends money, he lends the right to draw a cheque and promises to meet it on demand, so that the principle of mutual indebtedness as part of the basis of modern commercial currency is again evident. And since the right to draw a cheque implies the right to call for Bank of England notes, the extent to which credit can be created by bankers will depend, among other things, on the amount of notes that bankers hold against possible demands. A banker who has £10,000 in notes at his command would be running too great a banking risk if he advanced ten millions to the most unexceptionable customers against the most unexceptionable securities; for by doing so he would give them the right to take out ten millions in notes, and if even a thousandth part of the right were exercised, the banker's notes would all be gone. All this is perhaps a little premature in a chapter which purports to be dealing with cash transactions. But the cheque, like the bank-note, is at once cash and credit, and it cannot be too early stated and understood that every credit operation implies a possible cash transaction, and that prudent banking consists in making due allowance for cash demands involved by the creation of credit.

CHAPTER IV

THE BILL OF EXCHANGE

HAVING reviewed the various forms of cash, or money here and now, for which goods and services are habitually exchanged, and for which the money market exchanges money some day or money somewhere else, we proceed to the bill of exchange, a versatile credit instrument which is often all these three forms of money in the course of its career. The complicated relations between the different kinds of money, and their habit of melting into another, are well exemplified when it is stated that the cheque, with which we are supposed to have already dealt, is actually nothing else but a bill of exchange, with which we now propose to deal.

But there is this difference. A cheque is a bill of exchange payable on demand. A bill of exchange, as we shall see, is an order from A to B to pay a sum either to himself, A, or to a third party, C. When it is payable forthwith it is a cheque and bears a two-penny stamp; when it is payable at a future date it is a bill of exchange and bears a stamp *ad valorem*, varying with the amount of the sum named. It is characteristic of monetary nomenclature, which seems to try to confuse matters by applying illogical and confusing names, that the title "bill of exchange"

also blessed with a high level of general honesty among its members. And these features in the character of a cheque also made it obviously impossible that it could be given the privilege of legal tender, that is, that anyone could be bound by law to accept a cheque in payment for goods delivered or services rendered. No one could be compelled to take a piece of paper signed by an unknown person and purporting to be an order on a bank of which perhaps he had never heard. So that the cheque has had to fight its way to its present supremacy without this advantage, and to drive gold and notes out of circulation, except in small and special transactions, in spite of the fact that they were legal tender and it was not. This it was enabled to do by its safety and convenience and the power of the drawer, by varying the form in which he makes it out, to hedge it about with safeguarding restrictions, or to leave it convertible into cash by anyone who presents it. A cheque is merely an order on a bank from one of its customers to pay some of the money which it holds on his account to a third party, or to himself if he wants to take out cash. It can be manufactured with a piece of notepaper and a twopenny stamp, but it is much more usual to use one of the well-known regular forms supplied by banks to their customers.

The convenience of the cheque follows from its safety; if bank-notes are being sent, it is necessary to note all the numbers and register the packet; a cheque, protected by being crossed and marked "not negotiable," goes safely in an ordinary envelope. The words "not negotiable" do not make a cheque not negotiable, but their effect is, that no holder of a cheque so marked can pass on a better title to it than

he has himself; consequently, if it is stolen, anyone who takes it from the thief cannot claim on it. Further, the fact that it can be drawn to the exact amount required is a great advantage, and its return to the drawer through his bank, when it has done its work and been cancelled, is an additional convenience, and makes the cheque a record and receipt, as well as a form of payment.

But in considering the qualities of the cheque it must never be forgotten that it is a certificate immediately convertible into legal tender cash, which to-day means Bank of England notes. It need hardly be said that the great majority of cheques are never presented to be turned into cash; they are paid into banks by those who receive them, and crossed off against one another in the Clearing-house, where representatives of all the banks meet and exchange claims against one another; and cheques thus for the most part merely act as indicators in the transactions which result in the daily transfer of an enormous amount of credit from one hand to another, the whole affair being finally reduced to a matter of book-keeping exchanges between the various bankers and between the various accounts in their books. But the fact that every cheque gives the holder, or his bank, the right to demand legal tender from the bank on which it is drawn is highly important; without it, the cheque could not have won its way to general acceptability, and could not be treated as cash, as it is rather heretically treated here, on the ground that it is, in the vast majority of cases, readily accepted in exchange for goods or services in ordinary transactions. And the immediate convertibility into Bank of England notes, which is behind every cheque, means that an adequate

supply of notes to meet them on presentation is as necessary to bankers who supply their customers with cheque-books as an adequate stock of gold was to those who formerly made advances to them in the shape of notes, or promises to pay. In these days when a banker lends money, he lends the right to draw a cheque and promises to meet it on demand, so that the principle of mutual indebtedness as part of the basis of modern commercial currency is again evident. And since the right to draw a cheque implies the right to call for Bank of England notes, the extent to which credit can be created by bankers will depend, among other things, on the amount of notes that bankers hold against possible demands. A banker who has £10,000 in notes at his command would be running too great a banking risk if he advanced ten millions to the most unexceptionable customers against the most unexceptionable securities; for by doing so he would give them the right to take out ten millions in notes, and if even a thousandth part of the right were exercised, the banker's notes would all be gone. All this is perhaps a little premature in a chapter which purports to be dealing with cash transactions. But the cheque, like the bank-note, is at once cash and credit, and it cannot be too early stated and understood that every credit operation implies a possible cash transaction, and that prudent banking consists in making due allowance for cash demands involved by the creation of credit.

CHAPTER IV

THE BILL OF EXCHANGE

HAVING reviewed the various forms of cash, or money here and now, for which goods and services are habitually exchanged, and for which the money market exchanges money some day or money somewhere else, we proceed to the bill of exchange, a versatile credit instrument which is often all these three forms of money in the course of its career. The complicated relations between the different kinds of money, and their habit of melting into another, are well exemplified when it is stated that the cheque, with which we are supposed to have already dealt, is actually nothing else but a bill of exchange, with which we now propose to deal.

But there is this difference. A cheque is a bill of exchange payable on demand. A bill of exchange, as we shall see, is an order from A to B to pay a sum either to himself, A, or to a third party, C. When it is payable forthwith it is a cheque and bears a two-penny stamp; when it is payable at a future date it is a bill of exchange and bears a stamp *ad valorem*, varying with the amount of the sum named. It is characteristic of monetary nomenclature, which seems to try to confuse matters by applying illogical and confusing names, that the title "bill of exchange" should be given both to the genus and to one of the

species into which it is divided. Another distinction exists in the eye of the law, from the fact that a cheque according to its legal definition, must be drawn on a bank, whereas a bill may be drawn on a bank but is also often drawn on a merchant or accepting house, or any debtor who gives his creditor the right to draw on him. The practice of the market-place, however, does not always follow the legal definition of the cheque, but applies the word to any bill payable on demand. The element of time is thus the real outstanding quality in the bill of exchange, which separates it from the cheque and justifies my reservation of it to a separate chapter apart from the forms of paper cash.

Logically, the reasons which included cheques under the category of cash would perhaps include the bill of exchange. Goods and services are constantly given in exchange for bills; and a good bill, drawn on a bank or firm in England can always be turned into legal-tender money. But it has to go through two important processes before it can be so converted. It has to be accepted, and it has either to be discounted or to await maturity.

The bill of exchange is of immemorial antiquity. "It is probable," says a great authority on its legal aspects, "that a bill of exchange was in its original nothing more than a letter of credit from a merchant in one country to his debtor, a merchant in another, requiring him to pay the debt to a third person, who carried the letter, and happened to be travelling to the place where the debtor resided. . . . It was found that the original bearer might often with advantage transfer it to another, and the assignee was, perhaps, desirous to know beforehand, whether the party to whom it was addressed would pay it and sometimes

showed it to him for that purpose; his promise to pay was the origin of acceptances." [1]

It is obvious from this theoretical description of the early bill that it, like its modern descendant, was not immediately payable, since otherwise its bearer would most obviously and simply have tested the willingness to pay of the merchant on whom it was drawn, by presenting it for payment. Acceptance is nothing else than the promise of the party on whom the bill is drawn that he will pay it at due date; and this acceptance he signifies by writing his name across the face of it. A cheque, in its legal sense, drawn on a bank, does not require acceptance, because its payment constitutes and includes its acceptance; but a cheque, in the sense of a bill payable on demand, drawn on a firm which is not a bank, is often accepted.

It is rather astonishing to find the authority just referred to stating that there is no evidence that bills of exchange were in use among the ancients, though he refers to a passage in Cicero's letters which appears, to a lay mind, to establish the fact beyond doubt. Writing to Atticus,[2] Cicero asks him to consider whether the monetary requirements of his son at Athens can be provided by exchange operations, and it is interesting to see that the Latin phrase is a literal counterpart of the English—*permutari*. But although this passage is not sufficient evidence, from a legal point of view, that such a thing as a bill of exchange was used, it clearly proves the existence of some form of exchange machinery in Rome and Athens; and it is safe to assume that the acute and quick-minded Greeks exchanged credits against the goods that they bought and sold between their busy cities.

[1] Byles on Bills of Exchange. [2] Cic. *ad Att.*, 12, 24.

The precise age of the bill of exchange, however, is a question of merely antiquarian interest. We are now concerned with its meaning and the function that it performs in the monetary machine. It is legally defined as "an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a certain sum in money to, or to the order of, a specified person, or to bearer."

Thus says the law. But, as we have already seen, a bill of exchange becomes a cheque, in practice and in the eye of the tax-gatherer, when it is payable on demand; and in the eye of the law likewise when it is payable on demand and drawn on a bank. So that the distinctive part of its actual definition consists in its being payable at a future date. Further, though it may be an order drawn by one party on another in the same street, nevertheless, since trade consists largely in the exchange of goods between persons separated by distance, it is usual to find that bills of exchange are drawn by the merchants or financiers of one centre on those of another. In other words, time is a constant element in the composition of a bill of exchange, and space is a very usual one. When Sancho Panza had his ass stolen by a ruffian whom his master's chivalry had set free from the grip of the law, Don Quixote consoled him with a promise of a bill of exchange (*cédula di cambio*) for three asses out of five in his stable. As they were then wandering in the Sierra Morena, the elements of time and space were both present. The bill was duly drawn on Don Quixote's niece, and ran as follows:—

"Dear niece,—At sight of this, my first bill of ass-

colts, give order that three out of the five I left at home in your custody be delivered to Sancho Panza, my squire; which three colts I order to be delivered and paid for the like number received of him here in tale; and this, with his acquittance, shall be your discharge. Done in the heart of the Sierra Morena, the twenty-second of August, this present year——"

"It is mighty well," said Sancho, "now you have only to sign it."

"It wants no signing," said Don Quixote; "I need only put my cipher to it, which is the same thing, and is sufficient, not only for three, but for three hundred asses."

The draft was thus in many respects irregular; apart from the fact, with which the priest consoled Sancho when he found that he had lost it, that "one written in a pocket-book would not be accepted." Nevertheless, this bill drawn in jest by Cervantes on posterity more than three centuries ago, is a very fair parody of its modern counterpart. Its verbiage, of course, has been left out, the bill of to-day being generally drawn with business-like brevity; but it is a definite order to Don Quixote's niece, signed by his cipher, to pay a stated number of ass-colts, to Sancho, against value received from him at the place where the bill is drawn. The fact that this value received is wholly fictitious is not quite without parallel in modern practice. Modern practice, in its insatiable search for means of credit manufacture, has often found it convenient to create bills of exchange out of nothing, drawing them against aspirations or expectations or speculations. And cases have been known in which an attempt was made to give the "kites," or accommodation paper, so produced, an air of demure respect-

ability by some reference to goods passing, as imaginary as the three asses which Don Quixote states that he has received from Sancho.

The original essence of a bill of exchange was that it was a claim for the payment of a debt, based on the moving of saleable produce to the place at which it is expected to find a market. The custom which made it payable at a date subsequent to its arrival, and the arrival of the goods, was presumably arranged in order to give the merchant who received them, and owed the money for them, time to dispose of them and garner the proceeds. But his acceptance of the bill, or acknowledgment that he has to pay the money at its date of maturity, makes it immediately negotiable, or convertible into cash, by the process of discount, which will be explained later.

Let us take a concrete example, and simplify it by the elimination of many of the processes through which a modern bill actually passes.

Silas P. Watt, farmer, of Dakota, sells his wheat-crop for £2,000 to John Smith, of London, corn-dealer; John Smith sees no reason why he should pay for the wheat before it has been shipped, knowing that a month or two must pass before it has reached him, and been marketed and turned into money in his pocket. Silas P. Watt, on the other hand, sees no reason why, during all this interval, he should have parted with his wheat and should have nothing to show for it; and his banker or trust-manager, who has probably made an advance against it, is even more strongly convinced of the impropriety of such a proceeding. Consequently, thanks to the compromise which commerce has devised to meet this difficulty, Watt in Dakota draws a bill on Smith in London for

£2,000 payable at sixty days' sight—that is, sixty days, *plus* three "days of grace," after the bill has been accepted—and is able to give this bill to his bank or trust company to be realized in payment for the loan on his crop. The bank endorses the bill by signing its name on the back of it, and sends it to its agent in London, together with documents showing that the wheat has been actually shipped and insured against risks on the way, and on its arrival it is accepted by Smith, who writes his signature across the front of it to show that he acknowledges the indebtedness at the due date, and is given possession of the documents. It is thereupon, supposing Smith's name to be good and in sound credit, a negotiable instrument which can be discounted, that is, turned into as much ready cash as a promise to pay at a distant date is worth according to the current rate of interest. For example, if the £2,000 bill has still a month to run and the current rate of interest is 6 per cent. per annum, its present value will be decided by simple arithmetic to be £1,990.

This is a very simple example of the manner in which the bill of exchange facilitates trade by creating a piece of negotiable paper against a genuine trade transaction. Wheat was not wanted in Dakota, and is always wanted in London, and therefore its transfer from Dakota to London gives it value by putting it into the place in which it will fetch a price. The interval is bridged by the bill, which finances the transaction from its beginning to its end. When the bill falls due, if, as we may suppose for the sake of clearness, it has not been discounted, Watt or his bank (to whom we suppose him to have passed it on) applies through his London agent for the money, and Smith,

having in the meantime disposed of the wheat, has the necessary funds ready at his bank to meet his acceptance; the agent places the proceeds to the credit of the bank in London, to be used as it may direct. In actual practice, however, the bank's agent would probably have discounted the bill and so turned it into immediate cash on its arrival, and the bank in Dakota would already have sold drafts on London against it, to customers in America who had payments to make in England.

A bill, such as this one that we have imagined, drawn against the actual shipment of actual produce, and especially of produce of universal demand and immediate consumption, such as wheat, obviously possesses the great advantage of "paying itself," according to the common phrase in Lombard Street. The wheat comes to market and is sold, and cancels the debt created against it.

It thus begins to appear that the bill of exchange is not only a beautifully simple and efficacious device for financing commerce, but is also an ideal form of investment for bankers and others who are obliged by the nature of their business to keep their resources liquid, that is, readily convertible into cash.

For a genuine bill of the kind described pays itself automatically, as we have seen, at maturity, owing to the necessities of the community, which must have wheat or perish, and a banker who invests his funds by discounting good bills has only to let some of his bills mature without replacing them, in order to replenish his store of cash. Bills drawn against wool, cotton, hides, and other raw materials of the principal industries which are turned into articles of universal consumption are, for practical purposes, equally good;

for the goods behind the bill, being certain of a market, and likely, if anything, to rise in value in time of war or political scare, secure the acceptor against the chance of being "locked up," as it is called, with an asset which he cannot realize.

It is this quality, inherent in a genuine bill, which gave rise to the saying that banking is the easiest possible business to conduct, when once the banker has grasped the difference between a bill of exchange and a mortgage. We have seen that the genuine bill of exchange is easily negotiable before maturity, and on maturity is cash by the sale of the goods on which it is based. A mortgage or loan against real property, houses and land, is by no means readily negotiable, since the two expensive processes of survey and examination of title are involved before it can be transferred, and the security behind it is the most difficult of all to turn into cash, especially at times of political or other disturbance. "You may buy land now as cheap as stinking mackerel," says Falstaff, when he brings news of Hotspur's rebellion.

But, as a matter of practical fact, a number of the bills drawn have not always been of this genuine character, and the use of this admirable and efficient instrument of credit has been so extended, that the distinction between it and a mortgage on real property has sometimes been in favour of the latter, which has at any rate something behind it.

We have seen that the original justification of a bill of exchange arose from its being drawn against produce in the course of being marketed or being worked up into a state in which it would be more valuable, and that the bill bridged the intermediate period by providing the buyer and seller with an

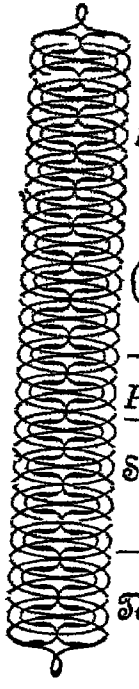
instrument that could be immediately realized. A very short step in advance of this arrangement led the dealers in exchange (or international money) to create bills at a time of year when no crops were ready to be drawn against, in order to make profits out of the provision of a form of remittance at these periods, and to cover themselves later on when the genuine produce bills began to come forward. Let us once more take a concrete case. In July, Silas Watt may want to make a payment in London for farming machinery; he has no crop to draw against as yet, but his bank will sell him a draft on London, having made arrangements with Smith, who is now grown from a merchant into an "accepting house," to accept bills drawn by it, for a consideration, against securities as well as produce. When Watt's crop is harvested, and a genuine bill on London is created by its sale, it will restore the American bank's credits in London, which were reduced by the draft that it had provided to pay for Watt's machinery.

When John Smith is described as having grown from a merchant into an accepting house, he is supposed to have passed through a process which has been a fairly common experience. Like many other merchant houses, he has given up the actual handling and selling of merchandise, though retaining the title of merchant, which is highly honoured in the City, and is confining his attention to the profits which he can more easily earn, if his name be good enough, by placing his acceptance at the disposal of borrowers who want to draw on him. The arrangement that he has made with Watt's banker, and with many other dealers in bills of exchange in other parts of the world, enables them to draw on one another at any time,

whether there be produce passing or no, and brings into being the instrument known as a finance bill. By this operation he and they create credit instruments which can be discounted and turned into cash, on the security of their names which are on the bills.

This system of creating bills of exchange, as long as they are created in anticipation of crop movements and other genuine processes by which products are given value by treatment and movement into the place where they are wanted, is quite legitimate, and tends, as will be explained in a later chapter, to steady the fluctuations in exchange, and to reduce the shipments of gold backwards and forwards across the hemispheres, that used to be involved by the working of the gold standard.

But having discovered that profitable business was to be done by creating bills in anticipation of movements of produce or manufactures, the enterprising spirits of the financial community were naturally impelled to go further, and create bills for the mere purpose of discounting them and so providing themselves with cash. As there was no moving produce in question, they were created against property that would be difficult of realization, such as landed estate, or against securities which might or might not be easy to sell, or merely against the credit of the creators, and all the varieties of bills so produced differ more or less essentially from the ideal form of bill of exchange, which, as we saw, paid itself on maturity by being drawn against actual movements of produce of general and rapid consumption. And there is often great difficulty in detecting from the appearance of a bill whether there be real produce behind it, or some other form of security, or nothing but the credit of the



No. 406.

EXCHANGE FOR £ 169·4·6 Stg. *Madras*, 11th June 1908

Three months after sight of this first of Exchange (second and third of same tenor and date not paid) pay to the Credit Bank of India or order

Pounds One hundred and sixty nine, shillings four, and pence six Sterling, value received, and place the same to account as advised.

Of 50 Bs. Hemp, per s.s. Napoleon to Bremen.

To Messrs. John Smith & Co.,
London.

LAING, MACKAY & Co.

LAING, MACKAY & Co.

parties. Some bills carry on their faces a history of the whole transaction involved. The subjoined specimen, faithfully copied, with names altered, shows that Messrs. Laing, Mackay & Co., of Madras, the drawers of the bill, order John Smith & Co., a London accepting house, to pay to the Credit Bank of India £169 4*s.* 6*d.*, against hemp shipped to Bremen in the steamship *Napoleon*. Laing, Mackay & Co. have probably sold the bill to the Credit Bank, and so provided themselves with funds for paying for the hemp. The bill is payable "three months after sight"; as it is drawn in Madras on June 11, we may suppose that it arrives in London on July 1. It is probably sent to the London office of the Credit Bank of India, by which it is immediately presented to John Smith & Co. for acceptance. They accept it by marking across it with a stamp—

ACCEPTED JULY 1, 1908.

PAYABLE AT THE CAPITAL & COUNTIES BANK, LTD.

and adding the signature "John Smith & Co." The bill is thus payable three months after July 1, with the customary three days of grace added, that is, on October 4. The bill is probably then discounted, that is, sold for cash, and on, or the day before, its due date the holder, whoever he may be, will pay it in, like a cheque, to his account at his own bank, which will collect the amount from the Capital & Counties through the Clearing House, and the Capital & Counties will debit John Smith & Co. The phrase which describes the bill as "this first of exchange" and orders its payment "second and third of same tenor and date not paid," shows that this is the original bill, and so the first of exchange. The "second and third" are

the duplicate and triplicate of it; the second of exchange is sent by another boat, as a precaution against delay, if the first should happen to go to the bottom of the sea, or be lost in the post. The third is generally retained by the drawer.

More often the bill takes a form like this:—

£2,000. NEW YORK, *Sept. 3rd*, 1908.

At ninety days after sight of this FIRST of Exchange (SECOND Unpaid) pay to the order of Messrs. Jones.

TWO THOUSAND POUNDS STERLING,

Value received, and charge the same to a/c as advised.

To John Smith & Co
London.

EVANS & PUGH.

Evans and Pugh.

Experts in credit may be able to hazard a shrewd guess from the appearance of a bill, as to what is behind it. But the phrase "Value received" covers a multitude of mystery, and the difference between a genuine produce bill and a piece of finance paper is often difficult to detect. Finance bills being based on securities which are less readily realizable, especially in times of apprehension and uncertainty, than genuine produce of general demand, are obviously more likely to land their acceptors in difficulty if they have been accepting too many of them. And it is thus easy to understand why, when there was any strain on credit, Lombard Street used in bygone days to talk seriously about the number of finance bills that were passing. Since the war, however, finance bills have been discouraged and diminished.

Another class of bill that becomes unpopular when the market for credit is in a nervous state is the "house

bill," that is, the bill drawn by a firm or company on itself. If, for example, John Smith establishes his brother Robert in Oporto to finance the port wine trade, and the Oporto Smith draws bills extensively on Smith in London, being merely an oversea branch of the same firm, the bills so drawn will not be as good as if they were drawn by one firm on another which is wholly distinct, and so carried behind them the credit and resources of two establishments. If this paper became too common, the watch-dogs of the credit organization would remark that there was too much Smith on Smith about, and would describe it, in its picturesque phrase, as mere "pig on pork."

The classical example of pig on pork is the order on Mrs. Micawber which Mr. Micawber gave to David Copperfield in the King's Bench prison. "Mr. Micawber," so David tells the tale, "was waiting for me within the gate, and went up to his room (top story but one) and cried very much. He solemnly conjured me, I remember, to take warning by his fate; and to observe that if a man had twenty pounds a year for his income, and spent nineteen pounds nineteen shillings and sixpence, he would be happy, but that if he spent twenty pounds one he would be miserable. After which he borrowed a shilling of me for porter, gave me a written order on Mrs. Micawber for the amount, and put away his pocket-handkerchief and cheered up."

David would have found some difficulty in inducing anybody to discount that bill, though doubtless Mrs. Micawber would have accepted it with a fine flourish, and with perfect confidence that "something would turn up" before it was presented. Nevertheless its complete worthlessness has been paralleled before now

in the world of commercial fact, when foreign firms have established branches, consisting of a clerk and an office boy, in England, and drawn bills on them, which have been accepted, of course, by the clerk, who had authority to sign for the firm by procuration, and have then actually been discounted and turned into cash.

Mr. Micawber has thus taken us a step further than Don Quixote. The Don drew a bill on this niece, whom he knew to be able and ready to meet it, in favour of Sancho, against a fictitious delivery by Sancho to him of three ass-colts. Micawber, in a debtor's prison, drew in favour of David on his wife, who was then in process of being sold up. He doubtless believed, nay was certain, that his paper was as good as gold. So do many others who draw on a branch establishment which possesses nothing but an office table; and this Micawberish optimism is at the back of a good deal of the exuberant energy which makes trade hum in times of activity. And consequently when trade slackens, and folk begin to consider sceptically concerning the basis of the credit that has been built up during the humming period, there are sometimes some awkward moments of surprise and disillusionment.

The importance of the bill of exchange thus lies in a merit and a danger attached to it. The merit is the fact that in its genuine form it facilitates trade by creating credits and so supplying cash against real produce not yet marketed, and is also an ideal form of investment for those whose investments must be liquid, or certain of easy realization. The danger is the ease with which it can be created against securities which may not be readily marketable, or by being drawn on firms by themselves, or by correspondents, in order to provide cash for speculative enterprise.

CHAPTER V

THE MANUFACTURE OF MONEY

(NOTE —The banking figures given in this chapter are out of date and do not reflect the war-time banking bulge; but they serve well enough as an illustration)

HAVING reviewed the various forms of cash or money here and now, and the bill of exchange, which, from its ready negotiability and from its becoming cash on maturity, may be described as very nearly cash, we may pause and look back over the ground already traversed.

We saw that gold, with auxiliary tokens of silver and bronze, was, until 1914, the cash of the pocket for retail transactions, but that its use in big commercial and financial transactions was economized first by the use of bank-notes, and then, when the law laid restrictions on the use of bank-notes which prevented any increase in their issue except against an equal amount of gold, by the use of cheques. But we found that the general acceptability of notes and cheques arose from their being convertible into gold, which was the only form of payment that is universally and always acceptable in the economically civilized world.

The restrictions on the bank-note have practically eliminated note issues in England except that of the Bank of England note, which being legal tender has itself become part of the basis of credit. That is to say, a banker who has Bank of England notes in his till is in a position to make advances to his customers

on the strength of them. The money of modern English commerce and finance is the cheque, and the credit dealt in in the London money market is the right to draw a cheque. We have next to find out how this right to draw a cheque is created, and we shall find that it is generally created by an advance, or a purchase of securities, made by a banker.

Since the cheque is an order to pay coin or notes, it is sometimes assumed that all these orders which are turned over by the London bankers' Clearing-house, to an extent that sometimes runs up to over 270 millions a day, are orders drawn by folk who have acquired the right to do so by depositing coin and notes with the banks. And it is a common popular mistake, when one is told that the banks of the United Kingdom hold over 2,000 millions of deposits, to open one's eyes in astonishment at the thought of this huge amount of cash that has been saved by the community as a whole, and stored by them in the hands of their bankers, and to regard it as a tremendous evidence of wealth.

But this is not quite the true view of the case. Most of the money that is stored by the community in the banks consists of book-keeping credits lent to it by its bankers. It is usually supposed that bankers take money from one set of customers and then lend it to other customers; but in most cases the money taken by one bank has been lent by itself or by another bank.

It will be remembered that when we were tracing the origin of the bank-note, we drew up an imaginary and simplified balance-sheet of a note-issuing bank showing—

Due to depositors	£10,000	Cash in hand . .	£10,000
Notes outstanding	40,000	Advances to customers . . .	40,000
	£50,000		£50,000

In order to simplify the matter, we left out the bank's capital reserves, investments, and other items which appear in balance-sheets, but, now that we have come to the point at which the manufacture of the right to draw cheques has to be made as clear as may be, it will be better to come into closer touch with the facts of the case and look at a bank balance-sheet of to-day. In order to get a fair average specimen I have taken the latest available balance-sheets of what are now known as the Big Five banks, and put their figures together. But before we can consider them it will perhaps be safer, in the interests of clearness, to try to arrive at some rough notion of the meaning of a balance-sheet.

A balance-sheet is a statement showing on the left side the balances of the amounts that have been received, or are owing, by the company or firm that issues it; and on the right side the amounts that have been paid out by it, or are owing to it, or are held by it. On its left side are the liabilities, on the right the assets. If you are not well versed in these mysteries you will probably be astonished to see the banks' capital among their liabilities; but reflection will show that the capital was subscribed to the companies by their shareholders, to whom they have to account for it, and was invested in the assets on the other side.

After this introduction to balance-sheets in general, let us examine the aggregated specimen that I have drawn up.

	Millions of £.		Millions of £.
Capital paid up . .	64	Cash in hand and at the Bank of England	225
Reserve Fund . . .	48	Cheques in course of collection, etc. . .	77
Current and deposit accounts	2,010	Loans at call and short notice . . .	170
Acceptances and endorsements on behalf of customers .	90	Bills discounted . .	267
Profit and Loss account.	6	Investments . . .	579
		Loans and Advances	774
		Liability of customers on acceptances, etc.	90
		Premises	36
	2,218		2,218

The above statement does not include the figures of the Bank of England, but is an agglomeration of the balance-sheets of the five biggest ordinary joint-stock banks—Barclays, Lloyds, Midland, National Provincial, and Westminster.

The first feature that strikes the casual observer is the smallness of the paid-up capital of the banks when compared with the vastness of the figures that they handle. We see that only 64 millions out of the 2,218 that they have to account for have been actually paid up by shareholders, though 48 millions have been retained out of past profits and accumulated in reserve funds, and 6 millions are due to shareholders, for distribution as dividend or to be carried forward, in the profit and loss account balance. It thus appears that a narrow margin of profit on their total turnover enables the banks to pay good dividends, and that the business of credit manufacture earns its reward, as might be expected, out of the credit that it makes.

Proceeding in our examination, we see that the item of acceptances and endorsements on behalf of customers on one side is balanced by the liability of customers on acceptances, etc., on the other. This means that the banks have accepted or endorsed bills for their customers (so making them first-class paper and easily negotiable), and are so technically liable to meet them on maturity; but since the customers are expected to meet them, and have presumably given due security, this liability of the customer to the bank is an off-setting asset against the acceptance. The acceptance and endorsement business done by the banks grew rapidly in the years before the great depression, but a bank's liability under it is not a liability in quite the same sense as its deposits, and since it does not immediately affect the present question of the manufacture of currency, it may be omitted for the present. We can thus simplify the balance-sheet by taking out this contra entry on both sides.

Further analysis of the liabilities shows that the capital, reserves, and profit and loss balance may be regarded as due from the banks to their shareholders, and that the remaining big item, current and deposit accounts, is due to their customers. This is the item which is usually spoken of as the deposits according to the tiresome habit of monetary nomenclature which seems to delight in applying the same name to a genus and one of the species into which it is divided. Just as the bill of exchange is divided into cheques and bills of exchange, so the banks' deposit accounts are divided into current and deposit accounts. But most people who have a banking account know the meaning of this distinction. Your current account is the amount at

your credit which you can draw out, or against which you can draw cheques, at any moment; your deposit account is the amount that you have placed on deposit with the bank and can only withdraw on a week's or longer notice (unless you really needed it at once, in which case, you would have to pay something for taking it); it earns a rate of interest, which used to be usually 1½ to 2 per cent. below the Bank of England's official rate. The official rate, however, has been 2 per cent. since October 1939, and the maximum deposit rate now given by banks is ½ per cent.

Now let us see how this huge debt from the banks to the public has been created. An examination of the assets side of the balance-sheet proves that most of it has been created by money lent to their customers by the banks, and that the cheque currency of to-day is, like the note currency of a former day, based on mutual indebtedness between the banks and their customers. For the assets side shows that the banks hold 302 millions in cash in hand at the Bank of England in course of collection, etc., 579 millions in investments, and 36 millions invested in their premises —the buildings in which they conduct their business— that 1,211 millions have been lent by them to their customers, including the British Treasury, either by the discounting of bills or by advances to borrowers, or by loans at call or short notice. This last item is generally described in bank balance-sheets as "money at call and short notice," but it has been lent, in most cases, to bill-brokers, whose functions will be described later; and though more readily called in than the advances to ordinary customers, it has nevertheless been lent, and so seems to be hardly money in the ordinary sense of the word. We can now reconstruct

our balance-sheet, leaving out the acceptances on both sides, as follows:—

	Millions of £.		Millions of £
Due to shareholders .	118	Cash in hand, etc. .	302
Due to customers. .	2,010	Investments . . .	579
		Premises	36
		Due from customers .	1,211
	2,128		2,128

And it thus appears that just three-fifths of the amount due from the banks to their customers are due from their customers to the banks, having been borrowed from them in one form or another. This proportion of loans to deposits, is, however, lower now than it was in 1928, when the fraction was not three-fifths but three-quarters. This change has happened because the basis of credit has been expanded, increasing the sum of cash held by the Big Five by £28 millions, and at the same time the demands on the banks for trade advances have diminished by nearly £100 millions. They have thus been obliged, in order to employ their increased resources, to add nearly £350 millions to their investments. But it still remains true that the greater part of the banks' deposits consist, not of cash paid in, but of credits borrowed. For every loan makes a deposit, and since our balance-sheet shows 1,211 millions of loans, 1,211 out of the 2,010 millions of deposits have been created by loans, and £579 millions by purchases of securities.

To show how a loan makes a deposit, let us suppose that you want to buy a thousand-guinea motor-car and raise the wherewithal from your banker, pledging with him marketable securities, and receiving from him

an advance, which is added to your current account. Being a prudent person you make this arrangement several days before you have to pay for the car, and so for this period the bank's deposits are swollen by your £1,050, and on the other side of its balance-sheet the entry "advances to customers" is also increased by this amount, and the loan has clearly created a deposit.

But you raised your loan for a definite purpose, and not to leave with your bank, and it might be thought that when you use it to pay for your car the deposit would be cancelled. But not so. If the seller of your car banks at your bank, which we will suppose to be Barclays, he will pay your cheque into his own account, and Barclays bank's position with regard to its deposits will be unchanged, still showing the increase due to your loan. But if, as is obviously more probable, he banks elsewhere—perhaps at Lloyds—he will pay your cheque into his account at Lloyds bank, and it will be the creditor of Barclays for the amount of £1,050. In actual fact, of course, so small a transaction would be swallowed up in the vast mass of the cross-entries which each of the banks every day makes against all the others, and would be a mere needle in a bottle of hay. But for the sake of clearness we will suppose that this little cheque is the only transaction between Barclays and Lloyds on the day on which it is presented; the result would be that Barclays would transfer to Lloyds £1,050 of its balance at the Bank of England, where, as we shall see in a later chapter, all the banks keep an account for clearing purposes. And the final outcome of the operation would be that Barclays would have £1,050 more "advances to customers" and £1,050 less cash at the Bank of England

among its assets, while Lloyds would have £1,050 more deposits and £1,050 more cash at the Bank of England. But the £1,050 increase in Lloyds' deposits would have been created by your loan, and though it will be drawn against by the man who sold you the car, it will only be transferred, perhaps in smaller fragments, to the deposits of other banks; and as long as your loan is outstanding there will be a deposit against it in the books of one bank or another, unless, as is most unlikely, it is used for the withdrawal of coin or notes; and even then the coin and notes are probably paid into some other bank, and become a deposit again; and so we come back to our original conclusion that your borrowing of £1,050 has increased the sum of banking deposits, as a whole, by that amount.

The same reasoning applies whenever a bank makes a loan, whatever be the collateral, or pledge deposited by the borrower, whether Stock Exchange securities, as in the case cited, or bales of cotton or tons of copper; or, again, whenever it discounts a bill. In each case it gives the borrower or the seller of the bill a credit in its books—in other words, a deposit; and though this deposit is probably—almost certainly—transferred to another bank, the sum of banking deposits is thereby increased, and remains so, as long as the loans are in existence. And so it appears that the loans of one bank make the deposits of others, and its deposits consist largely of other banks' loans.

When a bank invests in Stock Exchange securities, the same result happens—an increase in its own or some other bank's deposits. When a bank invests it will buy the security through a stockbroker, who will have an account with it, and it will pay him for the stock by crediting his account with the amount required,

which we will suppose to be £500,000. So far, the effect of the transaction is that the bank's assets have been increased by an addition of half a million to its investments, while its deposits are also half a million higher. But the broker immediately draws a cheque, to pay for the stock, in favour of the dealer—or jobber as he is more usually called—in the Stock Exchange from whom he bought it, and the jobber will pay a cheque to the broker from whom he bought, who will pay a cheque to the client who was the original seller. All these cheques between intermediaries will roughly cancel one another out, apart from small differences in the prices at which the stock changed hands and additions and subtractions for commissions, contract stamps, etc. It is also probable that the half-million bought by the bank, which we will call the Midland, was composed of many rivulets of small sales, and that many accounts would be affected before the bargain was paid and quitted. But in order to simplify the example we will suppose that the whole half-million was sold by an insurance company, and that it pays a cheque, for half a million or thereabouts received for it, into its account at (let us say) the Westminster Bank. Then the final result will have been that by the payment made by the Midland's broker, drawn on the credit which had been added to his account, the Midland's deposits will be left unchanged on balance, while half a million will have been transferred from the Midland's balance at the Bank of England to that of the Westminster, which will also have had its deposits increased by half a million. The Midland will show half a million more investments and half a million less cash at the Bank of England, and by its purchase it will have increased the deposits of

the Westminster, which will show a corresponding increase in its assets through an addition to its cash at the Bank of England, drawn from that of the Midland.

The manufacture of money is thus more difficult to follow under the system of banking by deposits and cheque-drawing than in the old days of note issue. When notes were the currency of commerce a bank which made an advance or investment or discounted a bill, gave its customer its own notes and created a liability for itself. Now, a bank makes an advance or investment or discounts a bill, and makes a liability for itself in the corresponding credit in its books; but this liability is in most cases almost immediately acted on and drawn against, and so transferred to another bank by being paid in as a deposit in the shape of a cheque on the lending or investing bank. This cheque gives the bank which receives the deposit the right to so much of the lending bank's balance at the Bank of England, and the average result of the vast mass of credits so created and transferred roughly balances itself.

In order to try to see the process at work, let us take out all the loans, discounts, and investments from the balance-sheet on page 48, and the corresponding deposits, and then build them up again. Their excision would leave the balance-sheet, simplified in other respects, thus—

	Millions of £.		Millions of £.
Capital and reserves .	112	Cash in hand, etc. .	302
Profit and loss . .	6	Premises	36
Current and deposit accounts	220		
	338		338

If, next day, each of the five banks lent ten millions and invested two millions which were drawn against and paid into one or other of the five, the aggregate of cash in hand and at the Bank would be unaltered, and the aggregate deposits would be increased by sixty millions, which would be represented by loans and advances on the other side, thus—

	Millions of £		Millions of £
Capital and reserves .	112	Cash in hand, etc. .	302
Profit and loss . .	6	Investments . . .	10
Current and deposit accounts	280	Loans and advances .	50
		Premises	36
	398		398

And so the process could be continued till we arrived at the actual figures originally shown. The supposition that the operations would result in transfers between the five banks, and not to any of the others, makes our example look artificial, though if we could get an aggregate balance-sheet for all the banks, this supposition would be fact, though complicated by possible withdrawals of coin and notes, which would, however, be a small fraction of the total transferred, and most of which would ultimately find their way back to the banks.

But perhaps we can make the matter clearer by eliminating the question of other banks, and their action and reaction on one another's position. Let us take the case of a little local bank with a complete monopoly of the banking business of a country town, in which it lends to everyone who is in a position to borrow, and takes the deposits of everyone who has a banking account. And let us suppose that this

community is completely isolated, as far as money matters are concerned, from the rest of the country. We may draw up an imaginary and simplified balance-sheet for the bank as follows :—

	£		£
Capital . . .	100,000	Cash in hand .	200,000
Deposits . . .	1,500,000	Investments . .	400,000
		Discounts and advances . . .	1,000,000
	1,600,000		1,600,000

With these small and simple figures before us, and the conception in our minds of the small and compact community whose banking business they represent, it is easy to see the whole thing at work in imagination. The little town could not have deposited £1,500,000 without advances from the bank because there never was such a sum in the place. It has presumably deposited £100,000, since the bank holds £200,000 in cash, of which £100,000 may be taken as having been contributed by the subscribers of its capital. The rest of the deposits have been provided by the bank itself which, on the strength of its £200,000 of cash, has discounted bills for the local paper-mill and chair factory, and made advances against any securities or commodities that its customers had to borrow on and it considered good collateral, and has also given credits in its books for £400,000 against securities bought by it.

The borrowers have generally been the producing, manufacturing, and trading classes, who have discounted bills and taken advances in order to finance themselves over the periods that necessarily elapse between outlay and realization in their various enter-

prises. This does not mean that their trade is unsound. They are earning regular profits; but before one profit is garnered they are at work in search of another, and borrowing the wherewithal to seek it; and by meeting their demands the bank is fulfilling the obvious and most useful business of a bank in financing production and industry. The land-holding, investing, and professional classes, who live ultimately on the producers and distributors, taking toll from them in the shape of rent, interest and fees, probably do most of the depositing, paying back to the bank the cheques that they receive, drawn by those who acquired the right to draw by a discount, loan or overdraft. Part of the loans raised by the producers and distributors will be drawn out in coin for the payment of wages, and will work their way round, through the tills of the shopkeepers, back to the bank, when the shopkeepers pay in; for the retail dealers necessarily, from the nature of their trade, habitually deposit a considerable amount of currency with their bankers, while other people generally deposit cheques. And thus it appears that the banking credits provided by the bank for one set of customers, in the shape of loans and discounts, come back to it from another in the shape of deposits created by the loans and discounts.

In this case we see that a bank in this exceptional and monopolist position can, on a small cash basis, create, by discounting bills and making loans, the right to draw cheques, confident in the expectation that the cheques drawn by one customer will be paid into it by another; or that, on the rare occasions on which the right to draw is used by withdrawals of actual coin or notes, the coin or notes will find their way back to it,

being deposited with it by those who receive them. And when its loans are repaid, or bills that it has discounted are met on maturity, this can only be done by the customers who have borrowed from it or taken bills to it for discount, paying it with a cheque on itself, and so cancelling a deposit; or perhaps by paying it in notes, which they will get from someone who has cancelled a deposit in order to withdraw them. And so its loans and discounts create deposits when they are entered on, and cancel deposits when they mature, though in actual practice their place would more probably be taken by fresh loans or discounts.

From this parable of a little bank in an imaginary isolated community we can see how an exactly similar process works in English banking as a whole, though in its case the question is complicated by transfers from one bank to another. The historical evolution of the business tells the same tale. Banking in its note-issuing stage lent currency to its customers in the shape of its promissory notes, and had on the assets side its loans, and in the liabilities, its notes outstanding. It manufactured notes which it lent. Now, it manufactures credits in its books, and current and deposit accounts have taken the place of notes outstanding on the debit side of its balance-sheets.

It cannot conduct this manufacture without the assistance of its customers, and it may be contended that these banking credits are manufactured, not by the banks, but by the customers who apply to them, and by the security that the customers bring, and the bankers approve of, as fit collateral. It is certainly true that the banks cannot make advances unless somebody asks for them, and their capacity for doing so thus depends on the needs of the community, and

also on the supply of unpledged property that the community has available as security. Whether the manufacture be conducted by the banks or by their borrowing customers is a question of little moment, as long as the fact is grasped that the greater part of the deposits shown in bank balance-sheets have been brought into being by means of book-keeping credits—whether in the form of discounts, advances, or overdrafts—granted by banks to customers, and passed on by these customers to others.

The broad conclusion arrived at is that banking deposits come into being to a small extent by cash paid into banks across the counter; to a larger but still comparatively small extent by purchases of securities by the banks which create book credits; and chiefly by loans from the banks, which also create book credits.

There is nothing alarming in this conclusion, though people who have been accustomed to regard bank deposits as so much cash paid in are sometimes startled when the other side of the matter is put to them, and feel that banking credit is a kind of questionable conspiracy between banks and their customers. A little reflection shows that it is a beautiful piece of evenly working mechanism, by which coin is economized and a practically efficient currency is provided with extraordinary ease and cheapness. Nor need any sense of disillusionment be felt when it is realized that bank deposits, in so far as they are borrowed, are evidences of indebtedness quite as much as of wealth.

Everybody knows that in all long-established, well-ordered and industrious communities vast stores of wealth are accumulated; and even if they could be heaped up in banks and expressed in figures nothing

would be gained by the information. But the contemplation of this mass of indebtedness, and of the cheque currency with which it is passed from hand to hand, is novel, stimulating and unique. It is a wondrous example of human ingenuity applied to the cheapening and furtherance of trade, finance and speculation, and its development has only been rendered possible by the confidence, based on solid experience, of the majority of Englishmen in one another's commercial probity, and readiness to carry out a contract at all costs.

The only defect in the system is its perfection. English banking has been so ably and successfully conducted, and has moved forward so steadily, especially since the foundation of the great joint-stock banks and the publicity which their establishment made necessary, that it sometimes becomes difficult to realize that banking is not merely a matter of quickening the wheels of commerce with a plentiful supply of credit when trade is prosperous, checking the growth of credit when it outgrows its cash basis, writing off a few bad debts occasionally, and, year in and year out, making splendid profits by lending people the right to draw cheques, on the assumption that nearly all the cheques so drawn will be cancelled against one another, and will never involve a demand on the banks for legal tender cash. To the modern generation of bankers, to whom such a thing as a run on an English bank is a matter of tradition, a mere echo of a bad old past which is gone for ever, banking is sometimes a little apt to present itself as the simple process described above. But the thoughtful bankers, that is the great majority of the wary, cool-headed men who carry on this curious and magical business of

providing currency and credit on a basis of mutual indebtedness between themselves and their customers, know well enough that there is another side to the question. Just as a man cycling through a crowded street depends, for his life, not only on his own skill, but also on the care with which the rest of the traffic is driven, so the English banking system is dependent on the sanity and sense of the public as much as on its own soundness.

This dependence of the banks on the sanity and sense of the public arises out of the fact that bank deposits are payable in cash, either on demand, or in theory at a week's notice; and even the deposits at notice are practically liabilities on demand, because if anyone who had money deposited at notice wanted it suddenly, a banker would find it very difficult to refuse to let him draw it. Hence it follows that if the public, or a considerable portion of it, became suddenly bereft of sense and sanity to a sufficient extent to make it want to take its money out all at once, the position of the banks would be uncomfortable, if they were not amply provided with legal tender cash, and so able to quell the outbreak by meeting its first demands with a bold front.

It might appear that since bank deposits, as has been demonstrated, are largely created by credits given by way of loan or discount, any bank which happened to be subjected to the inconvenience of a run would only have to call in loans from its debtors to meet the demands of its depositors. But the matter could not really be settled by this simple method, in the first place because banks habitually make loans for fixed periods, but have to meet liabilities, as we have seen, on demand; and, in the second,

because in the case of a panic severe enough to cause a run on a bank, a large number of its debtors would almost certainly be obliged to admit their inability to repay their advances. The bank would find itself reduced to the unpleasant predicament of having to try to realize the securities or commodities, or other collateral pledges, against which the loans had been granted, and in the state of panic which our hypothesis postulates would find it extremely difficult to do so, and would probably find it impossible to do so as rapidly as demands were pressed upon it.

Moreover, since we have already seen that the loans of one bank create the deposits of another, the attempt by one to call in its loans would inevitably cause pressure on the deposits of the others, and so the evil would swell and spread in a vicious circle. There is, however, no need to dwell on the possible horrors of a general banking panic, which is almost inconceivable under modern conditions. So much had to be said in order that the tremendous obligation might be realized which lies behind this business that is conducted so smoothly and easily, and that some appreciation might be gained of the responsibility that is faced by the affable and imperturbable gentlemen who conduct it. And it was also necessary to bring the skeleton out of the banking cupboard in order to emphasize the stern necessity for unceasing vigilance on the part of the banking world in the matter of its first weapon of defence against an outburst of public insanity which might start an importunate demand for cash from its bankers.

For in this matter the public and the banks act and react on one another, and the public is much less likely to be bitten with a mania for hoarding its

money instead of leaving it in banks, if it knows that the banks are strong enough to meet a sudden demand without flinching. And hence it follows that, by keeping a strong line of defence in the shape of legal tender cash, the banks can do much to prevent the danger from arising, against which it is intended to protect them. Just as we saw that the note-issuing banks ran serious risks when they made advances in the form of their own notes without due regard to a store of metallic cash in which to meet their notes when presented, so the modern cheque-making banks have to keep an adequate proportion of legal tender cash against the right to draw cheques that they lend to their customers or become liable to by other means.

If it were not for the fact that the credits which they lend represent the right to draw cheques payable on demand, the extent to which they could lend would be only limited by the demands of their customers, and the amount of security that their customers could provide. But this all-important fact makes the question of an adequate cash reserve against their liabilities an essential factor in the problem.

This reserve of cash consists of the Bank of England notes that they have in their tills and in their vaults, and their balance at the Bank of England; it is the first line in the assets side of the balance-sheet, "cash in hand and at the Bank of England." On the other side, among the liabilities, we saw the entry "current, deposit and other accounts," and, if you work out the proportion of cash against those liabilities, you will see what is the proportion which the banks, whose position is there displayed, think it right and proper to keep.

There is no hard and fast rule on the point in England, and it would be absurd if there were, for the circumstances of banking business differ so widely, that what is a barely adequate proportion for one would be wastefully excessive for another. Good banking consists in giving as much assistance as possible to trade in the matter of credit, but ceasing to expand credit as soon as the proportion between cash and liabilities touches the lowest point at which prudence and caution require that it should stand. This is the happy mean that the banker has to find. The exact point at which the mean stands is a matter which he is best able to judge; and though the desire to earn big dividends and the pressure of competition are strong incentives to him to place his ideal proportion too low, on the other hand the fine traditions of English banking and the wholesome dread of criticism, and of the moods of the multitude, are eloquent arguments in favour of wisdom and caution.

Good banking is produced, not by good laws, but by good bankers. Just as the most carefully planned constitution will inevitably break down if the men at the helm of government are incompetent or dishonest, so no skilfully devised banking system will make banking good, unless the banking is conducted by straight and able managers, or defend banking from suspicion by its customers, if other wheels in the financial machine have been proved to be unsound.

In the United States, before the Federal Reserve system was established, the national banks in the chief cities were compelled by law to keep a cash reserve equal to twenty-five per cent. of their deposits, and were liable to inspection by Government officers whose business it was to see that the cash was duly

there. And yet, the panic of the autumn of 1907 saw the banks of the United States obliged to suspend payment because of mistrust on the part of the American public, which would have withdrawn most of its cash if the banks had not adopted the simple expedient of refusing to pay it. This mistrust was no doubt exaggerated, and in the case of most of the American banks was wholly unwarranted. But Americans, in discussing the matter, generally admitted that it had a certain amount of basis. The mere fact of legal regulation of the amount of cash probably made the banks in America less careful with regard to the nature of the rest of their assets.

But the American monetary system, as will be shown in a later chapter, has been so radically altered by the establishment of the Federal Reserve banks, that the events of 1907 are now interesting only from an historical point of view, as showing that a legally imposed proportion of cash to deposits is, under certain conditions, no protection against panic—a fact that has been more recently and still more emphatically proved by the American banking panic of 1933.

In England, where the law imposes no rules on bankers in this matter, the public feels assured that its money is protected by the integrity and ability of those to whom it is entrusted. As long as this confidence lasts, all is well; but anyone who trades on public confidence has not only to merit it, but also to provide for any accident that might arise if, in spite of his meriting it, the public were to withdraw it owing to some mistake on its part. Hence bankers have to be constantly alive to the necessity of keeping their position strong.

And though, owing to the consolidation of the

banking position that has taken place in late years, the question of the cash holding is less important than it was; an adequate proportion of legal tender cash to liabilities is still a very necessary jewel in a banker's crown. And legal tender cash means Bank of England notes.

CHAPTER VI

THE WORLD'S MONEY MARKET

SO far money has been dealt with chiefly as a matter of internal experience, and from the point of view of the relations between the Englishman and his banker. In the account given of the origin and development of the bill of exchange the horizon was expanded for a time, but otherwise our attention has been concentrated on the forms of cash with which we English buy and sell commodities and services, and the process by which these forms of cash and the right to draw and use them, are created by our bankers and their customers, through loans against goods and securities.

But the money market is a very much bigger and more interesting affair than it appears to be from this merely insular examination. It is, in fact, the most interesting of all markets, because it is, or used to be, and may be again, world-wide to a greater extent than the market in anything else, with the possible exception of wheat. And in the international money market an immense revolution, the effects of which have lately been seen only too clearly, has been wrought by the war, and the great westward shifting of wealth that it caused.

The use of money in cash transactions is obviously world-wide; wherever men buy and sell they must

use some medium of exchange which is commonly accepted in their country. But money in its wider sense, in the sense of bankers' credits, is also a matter of world-wide use, or at any rate demand, and international monetary affairs have been profoundly modified by the rising in the western sky of a brilliant if somewhat erratic constellation, the American money market. When I wrote this book in 1908, the following passages, now dead as Queen Anne, were as true as I could get them :—

It is only in London that money of this kind is to be had freely, and in the fullest meaning of its real definition, which implies, as we have seen, the right to demand, and the certainty of receiving payment in gold.

It is clear that in order to be of any use in international finance, money must be immediately and unquestionably convertible into gold, the only form of payment which is universally and always acceptable in economically civilized countries. And money of this kind is only to be had in London.

In a pleasant American comedy produced very many years ago, one of the characters, holding out a bundle of papers to her husband, exclaims, "What's this? You said you'd give me some money!" "That's so," says the husband, "and so it is. Why, it's Wabash!" Wabash was the name of a railroad stock of somewhat problematical value, and quite useless as a medium of exchange for the purposes of household shopping. And anyone who has a credit in any other centre but London, is liable to find himself, when he tries to realize it and turn it into cash, met by an offer of Wabash, or something equally inconvenient for his purposes.

The French are clever and versatile financiers, and the unfailing thrift which distinguishes the inhabitants of their country gives it a great and almost unsatiable power of absorbing investments, so that Paris is a very important factor in the international loan market. But the French temperament is essentially cautious, and the Bank of France does not attempt to do the business that we regard as banking, which includes readiness to meet all demands in gold. Its notes are

convertible, but convertible at its option into either gold or silver; and it frequently takes advantage of this option when it considers it undesirable to part with its gold. So that anyone who has a credit in Paris has a credit which is of no international value, except in so far as he can make use of it, by means of the machinery of exchange, to buy a credit in London which is convertible as a matter of course.

In theory Berlin has a gold standard, and the notes of the Imperial Bank are theoretically payable on demand in gold. But Germany is young as a financial nation, and its banks have been so busily and deeply engaged in promoting the industrial activities of the country that their resources and energies have been hitherto absorbed by this task, which they have performed with great success. Consequently they have not yet addressed themselves to this question of international banking and of being prepared to meet all demands on them in gold; and anyone who wants to draw on the Imperial Bank's store to any large extent is likely to find obstacles and difficulties in his way, and is moreover likely to be met with a most discouraging countenance when next he requires accommodation. With the store of sagacity and scientific method that it has available, it is probable enough that Berlin may one day rise to the full responsibilities of a monetary centre, ready to face the real tasks of the international banker. At present, it is chiefly engaged with the solution of internal problems.

In New York the right to gold is less ostensible, but in ordinary circumstances more practicable. A credit in the United States carries with it the right to legal tender currency, and the general probability of securing what is called a gold certificate and turning it into the metal. But in the autumn of 1907, the whole American system broke down, and an interesting form of emergency currency, created to fill the gap caused by an outbreak of hoarding on the part of both the public and the banks, became the only available medium of exchange. It took the form of "clearing-house certificates" issued by the American banks, but whatever else they certified, it was not a certainty, or even a chance, of obtaining gold.

It is a cherished ambition among Americans to see New York some day established as the monetary centre of the

universe, and with their vast natural resources and population there is no doubt that the United States can achieve any material tasks that they choose, if they can learn the necessary lessons and develop the necessary character. At present the characteristics of the typical American business man seem to fit him to do most things better than banking. His haste to grow rich, his eager enthusiasm and buoyant optimism followed by plunges into apprehension and depression, his quickness and versatility, his keen sensibilities, his craving for speculative excitement, and his genius in exaggeration—all these qualities make him an excellent producer, a first-rate distributer, a miraculous advertiser, an unapproachable gambler, and a somewhat questionable banker. There are hundreds of good bankers in the United States, who take a scientific interest in the problems of their business such as is comparatively rare among their English brethren. But they are developed in spite of their environment, and of the atmosphere of eager enterprise which makes it difficult to observe the humdrum laws and limitations of banking.

In 1907, the American banks were so strongly suspected by their own public of having made indiscreet use of their opportunities and capacities, that the public preferred to take care of its own money. And American banking met the situation by refusing to meet demands on it. Banks that can be so suspected by their own public, and can meet the suspicion in such a manner, have much to do and undo before they can constitute themselves into an international banking centre. . . . When it has lived down this lapse, and provided the confidence that is now lacking, and the necessary machinery of a discount and money market, American banking may set about making New York the monetary centre of the world. And an American can learn anything, if he thinks it worth while.

Some of the smaller centres meet drafts on them in gold, but their limited resources limit their powers. Practical financiers of all nationalities will admit that a draft on another centre is only valuable from the international point of view from the readiness with which it can be turned, through the machinery of exchange, into a draft on London, which is the real cash of international commerce and finance, because money in the real sense of the word, gold or its equivalent, is

only to be had, always and without question, and to any amount, in London.

"These things," to vary Hamlet slightly, "were sometime a truism," but the first, or Kaiser's, war had wiped out their veracity, as an elephant wipes out an ant on which it treads. New York had arisen, an international money power with immense resources behind it, equipped with brand-new machinery, devised after years of research, in the light of the experience and mistakes through which other countries had fumbled their way; and had marked its rise to power with a collapse in which thousands of American banks failed and all the banks had to be closed for four days. Berlin had suffered a currency collapse which divided the value of the mark by millions, and had got a totalitarian Government which thought guns more important than butter. France, having seen the value of the franc divided roughly by ten, and having stabilized it at about one-fifth of its pre-war value as measured in pounds and dollars, had to submit to two fresh revaluations in terms of gold; and the whole international money market, once largely controlled by London's beneficent dominion—beneficent because London knew that beneficence paid—was in a state of chaos, with an enormous amount of "bad-tempered money" as it has well been called, floating from centre to centre in search of security, while international lending, except in the form of credits for armament purposes, was almost dead.

This disgusting state of things can be attributed entirely to the effects, direct and indirect, of the war of 1914–18, chief among which were the vagaries performed by America and the survival of political fear and rancour in Europe.

America was shoved into the middle of the picture by the four years which were spent by the European Powers, with centuries of statesmanship and political wisdom behind them, in mutual destruction. The people of the United States, first as neutrals and afterwards as belligerents, lent money and supplied goods to the combatants, and to other nations which had formerly gone to the combatants for money and goods, with such profitable effect that they leapt at one bound the whole length of a road that they would otherwise have taken years, perhaps generations, to traverse, and America became a world's creditor, instead of a debtor country. Since the war she has given away immense sums in charity to devastated Europe and has also lent enormously and with reckless imprudence and worse all over the world.

With regard to her war-time lending, especially that which was done by the United States Government when it was fighting or preparing to fight on the anti-German side, some of her European debtors have criticized her as a greedy and unconscionable creditor, because she has not been willing to wipe out these debts, contracted by brothers-in-arms, fighting for a common cause. These criticisms have little or no real foundation, because her interest in the result of the war was so much more remote than ours on this side, that she had no pressing reason to throw all that she had into the common pool. Moreover, though she did not wipe the debts out she made compositions which let the debtors off a good deal. But we are on surer ground when we criticize her trade policy, by which she aimed apparently at selling everybody goods, lending everybody money and taking as little as possible from them in goods and services. She not only

maintained a tariff, stiff to the point of prohibition, against manufactured articles, but by subsidizing shipping lines at the expense of the American taxpayer made it difficult for those of her debtors who try to work marine transport on business lines, to meet their debt charge by earning freights. This policy looks short-sighted, for a nation that drives her debtors out of business cannot expect them to pay; and the solution that America at first applied to the problem, namely, lending her debtors more money to pay with, leads finally to the finance of Alice in Wonderland.

At the same time, while this shower of wealth was pouring into the lap of this modern Danae, she had exchanged a monetary system which seemed to have been devised to show all the blots and drawbacks that a monetary system can contain, for one that has been described by Sir Edward Holden, an experienced English banker, as surpassing "in strength and in excellence any other banking system in the world." [1] It had, without doubt, very effectively cured the evils that marred the old one. The ordinary American banks are still, it is true, compelled by law to keep certain proportions (varying according to the place where the bank works) of cash to the deposits for which they are liable; but instead of coming to the end of their tether when the legal limit is reached, those that are members of the Federal Reserve system—the "member banks" as they are called—can now reinforce their reserves by borrowing from the Federal Reserve banks, which are the keepers of their reserves just as the Bank of England keeps the surplus cash of our Clearing banks. There are twelve of these

[1] See his speech to the London Joint City and Midland Bank shareholders on January 29, 1918.

Federal Reserve banks, scattered at strategical points over the broad area of the United States, and linked together by a Federal Reserve Board, sitting at Washington, and also by a very complete system of communication between them, by which the needs of one district can be met from the plenty of another, so that the whole country is united into one great money market, instead of being spotted over by thousands of unconnected banks with no common interest except to protect themselves by pulling at one another's monetary entrails. By this ingenious device of twelve central banks designed to work as one united whole, under the control of the Federal Reserve Board, the founders of the new American system avoided the charge of copying the methods of the Old World and blunted the edge of the evil associations left in the public memory by former experiments in central banking.

On paper the new system seemed to be as near perfection as could be expected from any human effort, if perfection in a banking system means infinite powers of credit expansion. The member banks could borrow from the Reserve banks as long as the former had "eligible paper" to offer to the latter for discount, and the Federal Reserve banks could issue notes as long as they had 40 per cent. gold reserve against them, and could exceed this limit on payment of a tax. If and when the system can pull itself together and work as a harmonious whole, it may be a splendid instrument for the wealthiest people in the world to play monetary melodies upon. But, though it did excellent work during and after the war, its subsequent behaviour has reminded one of Kipling's story of The Ship That Found Herself. You remember how when

the ship left Liverpool for her maiden voyage, her capstan and deckbeams and stringers and thrust block and pistons and screw and all the parts of her rattled and argued in different voices until at last, when they had all been buffeted into unity by the Atlantic billows, the ship spoke with her own single voice as she steamed into New York harbour. In the same way the listening world heard different voices from different Reserve banks, from member banks which begged to differ, from the Federal Reserve Board, the Federal Reserve Advisory Council, Wall Street operators and critical Congressmen and Senators; and though these juvenile defects might have been cured by time, as the new system grew into maturity, its early history first had to be blotted by a disaster which overwhelmed in 1933 the whole banking machinery of the United States.

For the creators of the Federal Reserve system, while showing great ingenuity and care in giving the American monetary organization a nice new head, had omitted to deal with the very serious weaknesses of its body. That body consisted of nearly 30,000 banks, many of which were merely little tin-pot money-shops, with a few thousand dollars on both sides of the balance-sheet, and a business confined to financing local industries and farmers and so ready to fall before the first breath of suspicion.

This fundamental weakness of the American banking system produced its devastating result in 1933, when the breath of suspicion had blown itself into a tornado. What happened may be recalled by the following extracts from an article in *The Times* annual Financial and Commercial Review by its New York correspondent, published in its issue of February 6, 1934:

Shocking disclosures at a Senate inquiry into the operations during 1927, 1928 and 1929 of one of the great New York banks and its affiliated securities corporation increased the panicky feeling now spreading over the whole country, a feeling not lessened by the publication, on the insistence of Congress, of figures showing that no fewer than 5,582 banks and trust companies had had to get help from the Reconstruction Finance Corporation (an official body set up to support banks in difficulties). . . . Hoarding within the country increased enormously and, with a flight of domestic capital, there were heavy withdrawals of gold by Europe. . . . By March 3, the day before Mr. Roosevelt took office, banking operations had been restricted or totally suspended in 29 of the 48 States, and on the morning of his inauguration several other States, including notably New York and Illinois, joined the list. . . . With all the stock and commodity exchanges and most of the banks closed, gold disappearing like water into sand, and business drifting into *rigor mortis*, the President acted promptly and with great decision. Unearthing legislation enacted during the Great War and through inadvertence never repealed, he used the authority given by it to lay an embargo on gold exports and gold withdrawals and to declare a four-day bank holiday. However, he made it possible for banks able to perform their usual functions to continue to do so under regulation . . .

and proceeded to summon Congress to an extraordinary session and secured from it an Emergency Bank Act which gave him dictatorial powers over the banks as long as the crisis should last.

With these things happening in the country that had been forced too suddenly by the war into the position of financial leadership, we cannot wonder that the international money market should have fallen into a condition of chaos—the wonder is, that the economic system of the world did not altogether go to pieces.

For readers, however, who are not familiar with these matters or whose memory of them is short, some

explanation may be needed of the causes which led up to this collapse; and some further reasons may be given for the contention, expressed above, that they may all be attributed, directly or indirectly, to the effects of the war.

Owing to the war, America not only found herself world-creditor and world leader in finance, but also had good reason to believe that she had intervened successfully to stop a barbarous struggle which was wrecking European civilization. Confidence in themselves and in their country's future, always wholesomely vigorous in the minds of Americans, was thus keyed up to concert pitch; and they proceeded to express it in the most widespread Stock Exchange gamble that ever drove a whole people into an ecstasy of speculative fervour. During several years before 1929 a large part of the population of the United States was making handsome profits by buying and selling shares in their railroad and industrial companies, and also by gambling in real estate. The question whether security prices were justified by current dividends was no longer considered. From current dividends they had proceeded, first and with some reason, to current earning-power as the more correct test of the value of a share, and had then given free rein to fancy and proceeded from current earning power to the earning power which might be expected in five or ten years' time, on the assumption that production and consumption and profits and general prosperity were going to expand with the cumulative consistency of compound interest. Such a basis for security prices can only stand as long as enough people believe in it. As the Psalmist says, "it flourisheth as the flowers of the field; for as soon as the wind goeth

over it it is gone" ; and winds from several quarters combined to shake the fabric of America's confidence, and then to topple it over and flatten it out in widespread ruin.

One of these winds was the result of the Wall Street gamble itself, which not only kept American money, which had at first been so recklessly poured out to foreign borrowers, more profitably employed at home, but also attracted funds from all the impoverished countries of the world to earn fat rates by financing the gamble. Gold was being sucked into America and credit was growing scarce elsewhere. Farmers and other primary producers, no longer able to borrow, had to sell their output for dwindling prices, and their purchasing power was thus reduced ; and it was already somewhat impaired, again by a movement traceable to the war, which had stimulated production owing to the insatiable demands of the belligerents, ready to pay any price for food and materials. As the *Economist* said in an article in its issue of January 9, 1937 :

> broadly, the years preceding the depression witnessed a marked expansion in the world's demand for raw materials and crude foodstuffs. But productive capacity increased even faster. Consequently, the increasing output of primary products could only be sold at declining prices. The downward trend was accentuated by the accumulation of unsold stocks, which, in the case of nine important primary products, increased by nearly 100 per cent. between December 1923 and 1929.

With the buying power of this numerically very important class thus reduced, doubt as to the continued prosperity of industry and growth of profits came like "an envious sneaping frost" upon the minds of the speculating public, and the tumble in security prices turned what had been a source of income and buying

power (fed by the expansion of bank credits) into an orgy of losses. With farmers brought to bankruptcy, industry checked, real estate shrivelling in value and Wall Street a sink down which the public's paper wealth was vanishing, America's banking system was faced with difficulties which might well have wrecked a much stronger structure.

And then, before it had time to pull itself together and deal with its domestic problem, there came upon it a fresh blow from abroad, when, in the autumn of 1930, the so-called "Hitler election" in Germany aroused or revived fears of intensified political friction in Europe, which had been left by the war in a state of chronic apprehension and bitterness. It was known that certain American banks were heavily committed in Germany; and as political apprehension developed into financial mistrust, and the failure of the Austrian Credit-Anstalt was followed by a run on Germany, the position of these American banks became so difficult that in June 1931 President Hoover, in order to relieve the international tension, proposed the suspension, during a year, of all payments on inter-Governmental debts, these being another legacy from the war which had caused much embarrassment and friction. France naturally wanted to know why she should come to the relief of a debtor who had been making ugly faces—through "*stahlhelm*" demonstrations and so on—at her across the frontier, and by the time that France had made up her mind it was too late; the run spread from Germany to England and in September 1931 forced her off the gold standard to which she had perhaps too hastily returned in 1925.

This brief outline of the causes which led to America's banking collapse in 1933 has surely sufficed to estab-

lish the truth of the assertion that the war and its after-effects were responsible for the demoralization of the international money market, and its practical obliteration, as far as long-term lending was concerned.

CHAPTER VII

THE CHEQUE-PAYING BANKS

WE have now considered the various forms of cash money, and the process of the manufacture of the money, or right to draw a cheque, which is dealt in by lenders and borrowers in the money market. And we have seen that the right to draw a cheque in England once carried with it the immediate and invariable right to demand gold, and so linked London with the other gold-using centres and raised the question of our gold stock, and of foreign demands for gold, to an importance which some people found inconvenient or even absurd. Before we can discuss this problem, we have to examine the various wheels of the great machine by means of which the London market carries on business.

In our chapter on the manufacture of money we formed a distant acquaintance with the greatest of these wheels, when we saw that the cheque currency of England is manufactured by the banks, largely through the loans and discounts by means of which they create deposits which represent mutual indebtedness between them and their customers.

The provision of currency for large transactions has thus passed into the hands of the other banks. The Bank of England's note issue has taken the place of the sovereigns that we used as pocket money before

the war and is also used as a basis of the cheque currency which the other banks provide, that is, is held in reserve by them to meet cheques that may be presented for payment in legal tender cash. Before we go further, however, we must make sure of what we mean when we talk or write about the banks. I have headed this chapter "Cheque-paying Banks," manufacturing a very ugly phrase in the hope that it may be clear. For it may be said that the essential function of English banking, which differentiates it from other institutions which are very nearly but not quite banks, is this fact that it gives its customers the right to draw cheques against credits arising sometimes from the deposit of cash, more often from advances against security or the discounting of bills, and is prepared to meet these cheques on presentation by paying notes across the counter. The phrase cannot claim the watertight completeness of a logical definition, but it is roughly descriptive. It includes the country banks, which in their turn bank with the London banks. The cheque-paying banks, in short, for the purposes of this inquiry must be taken to include the native banks of this country, with the exception of the Bank of England, which may be regarded either as the foundation of the banking edifice or as a pinnacle on its summit, but in any case stands by itself. But they do not include the merchant firms and accepting houses, who do a business which is often described as banking, and keep accounts for customers; but do not as a rule meet cheques drawn on them with legal tender cash, but endorse them as payable at one of the banks which we classify as cheque-paying.

It need not be said that banking groped its way to its present perfection through many difficulties and

mistakes. A Royal Commission which inquired into the subject in the early part of the nineteenth century laid bare the fact that in 1793 more than a hundred English country banks failed, and that in 1810 to 1817 six hundred closed their doors. Novelists of earlier generations made effective use of bad banking in the plots of their novels, and actual fact was even more romantic than fiction in the days when the speed of a post-chaise full of bullion might save a bank which was troubled by a run, and difficulties of transport were increased by the highwaymen who infested the roads. In 1793 "a general panic was raging in London; many bankers failed, some of whom acted for their northern brethren. Fresh London agents had to be appointed and duly advertised in the local papers. This helped to spread alarm. Every holder of a note was anxious to convert it into gold. Scores of country bankers were in London, trying, by any means, to gather the precious metal, with which, when obtained, they immediately posted home, disregarding the perils of robbery on the road. The very bank that had reported 'all quiet and undisturbed' on the 20th had before the close of the month (March) first a clerk and then two partners in London seeking gold, a supply of which they obtained and carried north with all speed. Mr. Rowland Burdon, partner in the Exchange Bank, Newcastle, was in the metropolis upon the same mission. On the return journey his post-chaise was stopped by footpads, who pinioned the banker and rifled his pockets. The bullion fortunately escaped their notice."[1]

It is recorded in the interesting work just quoted that the great banking family of Backhouse of Darlington were wont, when they found it necessary to

[1] Mabarly Phillips, *History of Banks, Bankers and Banking.*

replenish their gold store and were anxious to avoid the suspicions that would be aroused if they were known to be doing so, to drive quietly off in a gig as if about to visit a local meeting and to change into a post-chaise and four at Scotch Corner, a noted place on the North Road. The practice throws an interesting light on the extreme care which had to be exercised by bankers in early days in order to do nothing which could possibly excite suspicion. And having mentioned the Backhouse family I cannot avoid the well-known story of the attempt made, according to legend, by Lord Darlington early in the nineteenth century deliberately to break their bank. It is stated that he actually instructed his tenants to pay him their rents in Backhouse notes, meaning when he acquired a sufficient number of them to present them all at once, demand gold, and so make the bank put up its shutters. Jonathan Backhouse was apprised of this intention, and went off to London post-haste for the necessary supply of gold. On his way back one of the fore-wheels came off the chaise, and rather than wait to have the wheel replaced the banker piled the gold at the back part of the chaise so "balancing the cash" and driving into Darlington upon three wheels. "By this sudden *coup* the bank was so well provided with specie that when Lord Darlington's agent presented a very large parcel of notes they were all promptly cashed, the Quaker quietly remarking, 'Now tell thy master that if he will sell Raby, I will pay for it with the same metal.'"[1]

Finally, I must risk still further the charge of irrelevant anecdotage by telling the story of the man who came down the steps of his bank, the door of which

[1] Ibid.

had been closed against him, stumbled under the shock of his ruin into the arms of a friend, and apologized by saying, "The fact is, I had lost my balance."

It would be pleasant to linger over the romance and humours of the primitive days of banking, but it is perhaps still pleasanter, and certainly more profitable, to record that both the comic and tragic side of bank failures, as a common experience, are to the present generation only a matter of tradition. And yet they are not really a matter of very ancient history, and I have talked with a grey-haired manager of a country bank, now absorbed into a great joint-stock concern, who was behind his counter during a run and asked a customer who came in to draw his balance how he would take it, and was astonished by being asked for the bank's own notes.

The improvement in English banking has been coincident with the development of joint-stock banking, a fact which is the more interesting because it was noted by keen-eyed Adam Smith that the joint-stock system is particularly well suited to banking. His reasons are worth quoting. "Though," he says, "the principles of the banking trade may appear somewhat abstruse, the practice is capable of being reduced to strict rules. To depart upon any occasion from these rules, in consequence of some flattering speculation of extraordinary gain, is almost always extremely dangerous, and frequently fatal to the banking company which attempts it. But the constitution of joint-stock companies renders them in general more tenacious of established rules than any private co-partnery. Such companies, therefore, seem extremely well fitted for this trade." [1]

[1] *Wealth of Nations*, book v., chapter 1.

Apart from this regular working by rule and tradition, joint-stock companies have for some time been subjected to greater publicity than private firms. When there is a large body of shareholders, it is impossible to maintain the same dignified secrecy and reserve concerning the position of a business, which is generally observed by private enterprises: and any bank which has to issue a statement of its position is bound to issue a strong one, or it would at once be the subject of cavil and suspicion, which might have unfortunate results. Hence it is that publicity has compelled the banks to keep themselves strong, in wholesome fear of the criticism of their rivals and of other members of the monetary body. A good balance-sheet was soon seen to pay those who produced and published it, and the banks found that by giving publicity to their position they gained and maintained public confidence: so much so that nearly all the private banks, though not bound to do so by law, had taken to publishing annual or half-yearly balance-sheets, before they were gathered into the advancing ranks of their joint-stock competitors.

Publicity has thus done much for banking, though it won its way in the teeth of much opposition on the part of old-fashioned folk who thought it undignified. The regular publication of half-yearly balance-sheets was a great step forward. But much may happen between January 1 and June 30, and again between July 1 and New Year's Eve, and the freedom and facility with which the English system of banking works was a temptation to bankers to employ too freely the admirable machinery with which they supply credit and currency to the commercial and financial community, and to build up too big a basis of credit on too

small a foundation of cash. The fact that their doing so facilitates trade and finance and quickens the wheels of commerce all the more efficiently, as long as no untoward result follows, made it difficult to advocate reform without affecting the interests of a large and powerful multitude, and in 1908, when this book was first written, a good deal had to be said about the great difference in the practice of the various banks, in this matter of the information that they gave to their shareholders and their depositors concerning their liabilities and assets.

It was contended that the system then prevalent by which publicity was applied to banking, once a year in some cases, once a half-year in others, and once a month in others, was unfair and illogical, and that "the fact that obstinate resistance is offered to publicity, especially by certain of the country banks, only shows how necessary is its application." These criticisms were an echo of those voiced by the banks which had led the way in the fullness and frequency of their statements, and naturally tried to prod their lagging competitors into coming into line with them. In their eyes it was most unfair—to say nothing of the dangers of bad banking involved—that some of their competitors should be allowed to over-trade, as they were suspected of doing, by only being called on to show their proportion of cash to liabilities at much longer intervals than the most enlightened leaders of the banking world. "It has," I recorded in 1908, "been insisted over and over again by practical and distinguished bankers that the proportion of cash to liabilities, in the case especially of some of the country banks, is inadequate, and that periodical publication of their position is an important step towards a remedy for this

evil. All that is asked of the banks is that they should show what they are doing, and the reluctance of some of them to do so is not a good sign."

Since then, this question has become much less important, owing to the rapid march of the process of consolidation and amalgamation which has wiped out many of the weaker brethren of the banking fold, absorbing them in the ranks of the big battalions that now dominate the field. In 1908 there were sixty banks (apart from the Bank of England) in England and Wales. In 1936 there were nineteen Of these only ten published monthlystatements, but these ten controlled about 90 per cent. of the banking resources of the country outside of the Bank of England.

Owing to this process of weeding out small weak banks, the question of inadequate cash reserves has ceased to be a hardy annual in the speeches of bank chairmen. People with a craving for full and symmetrical statistics occasionally suggest that it would be more satisfactory if all the banks were obliged to publish figures as full and as frequent as those produced by any. But in these days this claim is put forward less owing to suspicions of too much creation of credit by those which do not issue monthly statements or go into much detail in their balance-sheets, than owing to a desire for more of such light on the state of industry and trade as is given by banking figures.

But one hardy annual of banking criticism, which bloomed in this chapter as originally written, still flourishes. "A periodical 'tightness of money,' as Lombard Street calls it, towards the end of every month, when the monthly statements of the publishing banks are being prepared," was then described as lead-

ing "irresistibly to the conclusion that some of them call in loans or diminish discounts, and so increase their cash holding in order to make their position stronger on the day of its publication." This practice, pleasantly dubbed "window-dressing" by one of those wags who do so much to brighten life in the City, still survived, until the beginning of 1947. Between the wars the banks which published monthly statements showed, therein, not the position at the end of the month, but the weekly average figures of the various items. It was hoped that this system would abolish periodical withdrawals of cash from the market by the banks, to make their statements look pretty; but in fact, though it may have made them less extensive, it made them more frequent, being a weekly absurdity instead of a monthly nuisance. In the inaugural address delivered by him as President of the Institute of Bankers on November 12, 1928, Mr. Frederick Hyde referred to window-dressing as "an operation which causes considerable disturbance in the money market at the end of each half-year and to a small extent each week. Although," he said, "it is of old standing and has been generally indulged in, I do not think that anyone would seriously defend it. Apart from all other considerations it fails of its purpose, for it misleads nobody. Window-dressing, which is a subject of weekly comment in the Press, loses all taint of deception, but equally loses all value as an advertisement." Very nicely put, but why, this being so, did it continue?

It has already been stated that the great improvement in English banking, which has changed the picturesquely exciting system illustrated at the beginning of this chapter for one of monotonous solidity, has

coincided with the development of banking by joint-stock companies. And it is interesting to note that the law of the land, as far as it could, presented an insuperable obstacle to this development. It gave a monopoly of joint-stock banking in London to the Bank of England, but it defined banking, as banking was when this monopoly was given, as the right to issue notes. But when the nature of banking changed, and it became the business of a banker not to give a customer a credit and let him take out notes, but to give a customer a credit and let him draw cheques, it was perceived that the Bank of England's monopoly did not prevent the establishment of joint-stock banks in London; and so the law, in spite of its manifest intention, was practically annulled by a change in banking practice which its framers could not possibly have been expected to foresee.

It was in 1834 that this discovery bore fruit in the foundation of the London and Westminster and National Provincial Banks, and since then English banking has passed into the hands of the joint-stock banks by their rapid development, by the readiness with which they absorbed the old private banking firms, and finally by the action of a large number of the latter, which were amalgamated in 1896 into a joint-stock bank, named Barclay and Company, and afterwards, Barclays Bank, after the principal firm among its components.

The distinguishing feature of the new banking which has thus grown up is the system of banking by branches. In former days each bank stood by itself with its customers all in one neighbourhood, and if it had branches they were quite few and confined within a comparatively small area. The new banking opens

branches all over the country, or buys the interests of other banks, and seems to seek to diffuse its business as widely as possible. The consequence is that English banking, instead of consisting of a large number of small firms or companies providing monetary facilities each for its little band of customers, has been systematized into a compact army, composed of a few well-regulated and strongly equipped regiments, each of which has its companies and outposts scattered up and down a big area, but worked from a common centre, and with excellently organized arrangements by which the needs of each district can be watched over and provided for.

This development has great advantages, the most obvious of which is the imposing magnitude of the gigantic modern banks as compared with the pygmy firms of the old system of separate entities. Since the banker trades on public confidence, and size is the most impressive quality for striking the public imagination, the process of amalgamation and branch building has certainly strengthened banking in a most important respect. And it need hardly be said that it has also done a great work in regulating the ebb and flow of monetary facilities and providing a number of channels, all connected with the central reservoir, by which the process of financial irrigation can be most easily and cheaply conducted, and the supply can most readily be applied to any part that may happen to be suffering from drought. As long as all goes well in the world of banking, the present system will readily be acknowledged to be a great improvement on its predecessor.

At the same time, it must not be forgotten that this multiplication of bank branches has also multiplied the number of points at which the banking body is

vulnerable, and that, if it should so happen that all did not go quite well in the banking world, and every branch open became a sucker instead of a feeder, the magnitude of the defenders' task would be greatly increased by the diversity of the outlets for the bank's life-blood. A cash reserve which would be adequate enough for an institution which keeps all its liabilities under one roof may easily be meagre for one which has smaller liabilities scattered over different points in a score of counties.

From this point of view the size of a bank, which is so striking an indication of solidity in the eyes of the uninstructed, presents a different aspect on closer examination. For it is usual to measure the size of a bank by its deposits, in other words by its liabilities, and by the number of its branches. And when the liabilities are not only great but widespread, they become still more misleading as a test of greatness. In estimating the wealth of an individual we should hardly begin by enumerating the number of millions that he owed, and the number of places in which he owed them. We should admire the magnitude of his credit operations, but in assessing his solidity we should most of all want to know how liquid were the assets which he held against this mass of debt. And so with banks. The bigger they are, and the more widely scattered their places of business, the greater is their need for prudence and foresight. It need not be said that these platitudes are fully recognized by those in charge of the many-branched banks.

It must also be remembered that the recent consolidation of banking in England, and the ease and quickness of modern transport, have greatly reduced the dangers involved by branch banking. And the

experience of the United States shows clearly that greater risks are run by a system of many small single banks. There, even before the general collapse described in the last chapter, bank failures were a regular feature of the country's experience—662, with deposits of 193 million dollars, suspended in 1927, and 491 with deposits of 138 million dollars in 1928,[1] though in neither of these years was there any suspicion of banking crisis.

We have seen that the banks, by creating the cheque currency with which English commerce and finance is now conducted, play a supremely important and responsible part in the domestic economy of the London money market; and the loans and advances which we saw (in our balance-sheet on page 48) to be by far the biggest item among their assets, are chiefly supplied to British industry and trade, which they feed and fertilize.

In international affairs their power has been clipped by the closer control over the market now exercised by the Bank of England, though it has been expanded by the extension of their activities in acceptance and foreign exchange. Formerly in normal times, that is, at times in which it was not necessary for the Bank of England to intervene and control the position, they regulated the price of money in London as indicated by the rate for day-to-day loans and short fixtures, and the discount rates for bills of all dates. To a certain limited extent, it is true, they were controlled or affected at all times—or at nearly all times—by the Bank of England's official rate, because the allowance that they made to depositors for the use of their money was generally—in pre-war days—1½ to 2 per cent. below Bank rate. But, besides the funds which

[1] *Federal Reserve Bulletin*, April 1929, page 261.

they held on deposit, they also had very large sums left with them on current account, on which they in most cases paid no interest at all, so that it often happened that they could and did lend in the money market at a lower rate than they paid to depositors. And the price at which they lent in the money market made the market rate for loans, except on quite rare occasions.

It seems to be impossible to go straight forward in this inquiry, and now we must pause and explain the meaning of this phrase, the market rate for loans. If I may be allowed to express it with a view to clearness and simplicity rather than fullness and precision, it means the rate at which the banks are prepared to lend money—or the right to draw a cheque—to the bill-brokers. The bill-brokers ought to be explained too, but they must wait for the next chapter, and in the meantime can be described roughly as specialists who devote themselves to discounting bills, or acting as intermediaries in the discounting of bills. If you look at the aggregate bank balance-sheet drawn up to illustrate our chapter on the manufacture of money, you will see on the right-hand side among the assets first the cash in hand and at the Bank of England, the bank's first line of defence, and then "loans at call or short notice."[1] These loans are made day by day by the banks to the bill-brokers, money lent to whom is regarded by bankers as a second line of defence, since it is habitually placed either "at call" from day to day or for periods which do not usually exceed a week; and can thus, in theory at least, be called in readily. The phrase also, in some cases, covers loans from banks to stockbrokers; but when the rate for money is

[1] Page 48.

quoted in the City, it usually means the rate between banks and bill-brokers. And anyone who reads the opening paragraph of a newspaper money article and is puzzled to find that there was very little demand for money, and day-to-day loans were easily to be had for some apparently absurdly unremunerative rate, need not therefore infer—as sometimes happens—that a great revolution has been effected in human nature, and that money is no longer an object of man's ambition. The phrase generally misleads those who are not used to City jargon, and I once heard an indignant gentleman in a railway carriage vehemently asserting that the newspapers talked infernal nonsense, because he had apparently strayed by some mistake into the money article of the one that he had been reading, and had learnt from it that money was "unuseable," and that balances had been offered in vain at 1 per cent. It appeared that he had spent the previous day in a fruitless endeavour to induce his bank to allow him an overdraft on the security of certain pictures, apparently his own works, and of quite problematical value; he had offered to give up to 10 per cent. for the accommodation, and was so deeply stirred by the statement that there was no demand for money at 1 per cent. that he roundly dismissed all City journalists as unfit even to be art critics, which appeared to be the extreme limit of condemnation in his opinion.

It is very important that the meaning of the word "money" as used in the City should be clearly grasped, for we shall find that the rate for this money and the facilities for getting it are most important wheels in the machine, and it is essential to keep a tight hold of the correct significance of the phrase.

Money, then, has a special sense when spoken of by the chief dealers in it, thus presenting yet another example of the confusing inconsistencies of economic nomenclature. In this sense it is usually a loan granted by a banker to a bill-broker for a day or for a period not exceeding a week. The rate for this class of accommodation thus represents the price of the right to draw a cheque given to a borrower of the highest possible credit against securities of the highest possible class, and for the shortest possible period. And it is thus quite misleading to draw any inference from it concerning the rate that ought to be paid under different conditions.

This rate is, in normal times, practically decided by the cheque-paying banks. Other lenders, such as the Dominion and foreign banks, or the finance houses or merchants, sometimes have large balances employed among the bill-brokers, but the deciding voice concerning the value of the rate for short loans is ultimately that of the English banks. And the extreme elasticity of this rate was formerly one of the difficulties that had to be coped with by those who controlled the London money market. In those days many of the difficulties of London's position arose from the fact that many members of the money market did not adequately recognize that it has to be controlled, and that even those who did wavered constantly between the horns of a dilemma which was ever present, one being their own immediate interest, and the other that of the market as a whole and in the future.

For example, any given banker at any given moment might most reasonably consider that the rate at which he lent money to the bill-brokers was a question which merely concerned himself and his duty to his share-

holders. He had so much cash, so much invested in securities, so much advanced to customers, and a further proportion which he could, according to the rules by which he regulated his business, lend to the bill-brokers at call or short notice. Any rate for this was better than none, and, if the bill-brokers only bid him 1½ per cent. for it, why should he not take it rather than lose the profit to be made by the creation of so much credit? If he did not, he would very probably cause the bill-brokers to go across the street and bid a rival bank 1¾ per cent., and the only result of his abstinence would be to swell the profits of a competitor. From the point of view of the individual banker these arguments were irrefutable, but from that of the market the results of their practical application were sometimes unhappy. "It is much to be desired," I wrote in 1908, "that some system could be devised of more harmonious agreement among bankers as a whole, by which the rate for money, in the City sense of the word, could be made less mercurial, and especially could be prevented from falling to a merely nominal level, and so unduly depressing discount rates, encouraging all kinds of kite-flying and the production of finance paper, turning the foreign exchanges against London, and increasing the difficulties of those responsible for the maintenance of the gold reserve."

When this book first appeared I was reproved by my bill-broker friends for this and other passages in which I had urged the establishment of a link, elastic but effective, between Bank rate and the market rate for money. To bill-brokers, as we shall see when we come to look at their functions in the next chapter, plenty of money is part of the definition of the monetary Paradise, and I was accused of advocating

the establishment by the banks of a permanent corner in money. But violent fluctuations in loan rates are not good for Lombard Street, and after the Kaiser's war the banks adopted the habit of only lending to bill-brokers at a rate which was definitely agreed to by them all and was to some extent regulated by the Bank of England's official rate, commonly called Bank rate.

This system gave the Bank of England closer control of the price of money, and this control has also been strengthened by the effect of banking consolidation and finally by the nationalization of the Bank in 1946.

The cheque-paying banks were also, in former days, chiefly responsible for regulating the discount rate in London, that is, the rate at which bills of exchange drawn, as described in a previous chapter, for payment at a future date, could be turned into immediate cash. This market rate of discount was an even more momentous matter than the market rate for money, because it had a very important bearing on the foreign exchanges, another of the complicated questions which have to be dealt with later on. The importance, in fact, of the market rate for money arose largely out of its effect on the market rate of discount; if the bill-brokers were supplied freely with money at low rates, and thought that they saw a probability of the continuance of this free and cheap supply of credit, they were naturally encouraged to discount bills at low rates, so that the power which regulates the money rate thus exercised a strong and direct influence on the discount rate.

Though the banks had to a great extent surrendered this power, they still exercised a strong influence by being themselves large discounters of bills, so much so that many bill-brokers contended that it was the

bankers who directly determined the market rate of discount. And this was probably true, for most of the bill-brokers are chiefly intermediaries, and only discount bills with the object and intention of promptly rediscounting the greater number of them; and the bankers were the chief buyers with whom they could most regularly count on placing the bills that they took; consequently, when it was known that two or three of the chief banks were not taking bills below, for example, 3 per cent., this fact had a marked effect on the market rate of discount, that is, the rate quoted by the bill-brokers. And as the market rate of discount used to be an important factor in influencing the foreign exchanges, which in turn were an important factor in influencing the inward and outward movements of gold, we come round once more to the great importance of the policy pursued by the banks with regard to discounting bills.

Still more important and delicate do their duties become when there arises any question of discriminating between the classes of bills that will be taken, whether the objection be to bills of a certain kind, or to bills drawn on a certain house. By merely intimating to the bill-brokers that he does not want many[1] "house bills," or many bills drawn on a certain name, or that he is not taking paper which is too obviously of the kite-flying order, a bank manager can at any time profoundly affect the inner working of the financial machine. The exercise of such a power has to be handled with the nicest discretion, for any such intimation, especially when the paper of any particular accepting house is objected to, generally produces a good deal of gossip and conjecture, and is certain to

[1] Page 42.

have some effect on the credit of the firm that is indicated as having been accepting more heavily than its resources are considered to warrant.

And this part of the bankers' duty in watching over the volume of acceptances, and seeing that the accepting houses do not overstep the bounds of prudence, is complicated by the fact that the banks have themselves lately taken up the business of acceptance to a greatly increased extent. But at present the question of ordinary bills and their financing has retired into the background, snowed under by the enormous mass of Treasury bills and other Government obligations.

Further, the bankers, in times that were once thought to be normal, fulfil a highly important function by providing facilities for Stock Exchange speculation. This they do directly by making loans to their customers on the security of stocks and shares which the latter buy, not as investments, but because they think they will rise in price, or will return a higher rate of interest than the rate which the banker will charge for the loan; and indirectly by making loans to members of the Stock Exchange which the latter employ in financing the speculative commitments of the public. The rates earned by bankers for this kind of accommodation are generally profitable, and only the most strait-laced moralists question their right to provide credit for this purpose. In fact, in the case of direct loans to his ordinary customers, the banker need not necessarily know that the transaction is intended for speculation. Let us suppose that you arrange with your banker for an advance against a line of Greek bonds, which you want to buy because you think you see a chance of reselling them at a profit, or because you can buy them to pay you 7 per cent., and you can get a loan from

your banker at 5 per cent., and pocket the difference of 2 per cent. In such a case, as far as your banker knows, you may want the credit in order to buy a house, or to engage in some productive commercial operation. Nevertheless, in most cases he is probably in a position to make a fairly accurate guess, and when he is lending directly to members of the Stock Exchange, he knows well that in nine cases out of ten he is financing the purchase of securities by those who for one reason or another are not in a position to pay for them, and so is facilitating the speculative holding of stocks as opposed to the real possession of them by investors who have paid for them out of savings.

By performing this function, within due limits, the banker is carrying out a perfectly legitimate side of his business, and assisting operations which are beneficial to the community as a whole. The majority of speculators probably lose more money than they make, but if they choose to indulge in this expensive form of amusement, it is not, in normal times, their banker's business to interfere with it, and during the course of the process they are unconsciously rendering a financial service by promoting the freedom of markets and facilitating dealings in securities, and so indirectly promoting enterprise and trade.

Nevertheless, the readiness with which bankers can place credit at the disposal of speculators sometimes has bad effects, which have to be watched for carefully by those who regulate the supply of it.

For example, there can be no doubt that it was an important cause, among others, of the abnormally high level to which the prices of well-secured stocks were forced in the period of exceptionally cheap money in 1896–7, when Consols touched 114, and "gilt-

edged" securities could with difficulty be found to yield the buyer 2½ per cent. This state of things was a great hardship to the real investor, and was undoubtedly brought about to some extent by the number of enterprising folk who borrowed from their banks at 1 per cent. or so against gilt-edged securities yielding 2½ per cent., and pocketed the difference accruing from the yield on the stock and the profit arising from the advance in its price, which continued merrily up to a point. The demoralization of the gilt-edged market, dating from that golden period, and quickened by subsequent wars and other causes, was still being painfully lived down, when the Kaiser's war came and showed it what demoralization really could mean. But this is a point which perhaps does not directly concern the banker, as such, though as a large holder of securities he is affected by any tendencies which warp the true course of markets. Still, he is quite justified in arguing that he is not to blame if his customers, by the use that they make of the credit that he gives them, produce abnormal effects on prices.

More to the purpose is the fact that Stock Exchange securities are only to a limited extent liquid, that is to say, realizable at a moment's notice, and that the more a banker wanted to call in credit granted against them the less liquid they would be. It was once gravely contended by a gentleman who was opposed in principle to the existence of Government debts, that if every holder of Consols wanted to sell at once, and there were no buyers, the price would be *nil*. Which is one of those absurd truisms which contain their own refutation in their very truthfulness, but nevertheless are only caricatures, so grotesque as to be unrecognizable, of a very real fact. In this case

the fact is the less exciting platitude that the more people there are who want to sell stock, and the fewer who want to buy it, the lower its price will be, and the less easy it will be to sell it at all. It used to be boasted that the market in Consols—then the premier British security—was so free that they could be sold on Sunday. And there are securities enjoying the advantage of an international market, that is, of being freely dealt in in Paris and on the other Continental Bourses, which can really be disposed of at any time, at a price. But they are not many, and in times of difficulty or crisis, the possibility of which can never be wholly absent from the mind of a prudent banker, it is quite conceivable that securities, quoted officially at substantial prices, could not be turned into cash on any terms, and that the lending banker might find the credit that he had granted used to draw away his cash, without being able either to compel his customer to repay him or to convert the collateral and so replenish his resources.

From this it must not be inferred that bankers commit any indiscretion in conducting this class of business to the moderate extent that is customary here—an extent that has been severely reduced since the collapse in Stock Exchange prices after 1928. All these matters are questions of degree, and if due attention be given to the class of security advanced against, and the extent to which these transactions are entertained, nothing can be said against them by a reasonably minded critic. The finest class of security for a banker to hold or to finance is the bill of exchange drawn against real produce of universal consumption which is moving into the hands of those who will consume it, and so will pay for itself in due

course. In all other securities the existence of a buyer to meet the views of the seller is more or less problematical. However intense the panic, the human race must be fed and clothed, but the extent to which it will take securities from those who want to sell them will vary in an inverse ratio to the severity of the panic. And though it would be absurd to argue that bankers ought to hold nothing but produce bills, the limits to the negotiability of some other securities should be constantly kept in view.

This chapter has grown to a portentous length, which must be excused owing to the great importance of its subject. "I am always willing to run some hazard of being tedious in order to be sure that I am perspicuous," said Adam Smith, and was fortunate in being able to write so confidently. I have to face the certainty of being tedious, and can only hope that I run some hazard of being perspicuous. What I have tried to make clear is the important function of the cheque-paying banks in the English money market when it is a market, and not a "controlled institution." Recapitulated in tabular form it may be expressed thus:

By providing their customers with cheque-books they create the currency which settles the great majority of commercial and financial transactions and much of the retail traffic of daily life.

By lending money to industry and trade, discounting bills and making advances to bill-brokers and other customers they create the credits by which enterprise is fed and commerce and finance are carried on; and these credits become in turn their liabilities on current and deposit account.

They exert an influence, second only to that of the

Bank of England, on the current rates for money in London, and on the discount rates current in London, which have, or used to have, an important effect on the foreign exchanges, and so on the stability of the exchange value of the pound.

They are large acceptors of bills, and so, again, facilitate commerce and create instruments which are readily convertible into cash or credit.

Since the war they have developed a large business in foreign exchange, so furthering international trade, finance, travel and intercourse.

By advancing to customers or stockbrokers against Stock Exchange securities they facilitate speculation, and thus to some extent affect the prices of stocks and shares.

It is a tremendous function, and it follows obviously that the cheque-paying banks are in the aggregate the most important members of the financial body. We shall find that, with one exception, the other members are more or less dependent on them, and can only work with the assistance of the credit created by them. The one exception is the Bank of England, which exercises special functions which will be more fully described hereafter, and leads and regulates the whole course of the money market. But even it derives much of its power from the fact that it acts as banker to the cheque-paying banks.

As originally written, this chapter, which had already, like King Charles, apologized for taking an unconscionable time over dying, died at the end of the last sentence. But nowadays Iago sets the fashion and we are all "nothing if not critical." Having seen what the banks do, we have to consider whether they might not do it better. They are charged with having

grown so big that they are unwieldy, and the *laudator temporis acti* is fond of telling us that now that all the small country banks have been gobbled up by the octopuses with heads in the City and tentacles sprawling all over the place, the bright lads in the villages and the country towns do not get the backing, in the shape of credit, that was to be had in the good old days, when the partners in the private banks managed their own businesses, and knew all their customers and all their families and circumstances and could appraise their solvency to a hair's-breadth.

On the other hand the octopuses have plenty to say for themselves. In defence of the policy of amalgamation and absorption, they can urge, with obvious truth, that it has been forced upon them by the similar process in industry, which has made the industrial units so vast, that the little banks of a past generation could not possibly have met their legitimate demands for credit. But they can go further, and say that while opening magnums and Jeroboams for the heavy drinkers, they are still ready with half-bottles and " nips " for the humbler thirsts. And they produce figures to prove it.

Mr. McKenna, chairman of the biggest of them, gave an analysis, in his speech at the annual meeting on January 22, 1929, of the advances of the Midland Bank, outstanding on June 30, 1928. After making full allowance for bad and doubtful debts, they amounted to the impressive total of £214 millions odd, and they were extended to more than 180,000 borrowers, the average amount outstanding being about £1,200. Among the groups in the classification, one of the largest was composed of the wholesale and retail traders, who took 11¼ per cent. of the whole. More

than two-fifths was lent to retailers with a single place of business: the bank had 31,000 loans of this particular character, the average amount being £330. Loans to agriculture, for financing current agricultural requirements, numbered nearly 15,000, the average amount being less than £500.

These figures do not look as if the small user of credit was being starved, and one does not see why the banks should be such fools as to starve him. From the nature of the business, bankers and their customers must always differ as to the amount of credit that the latter ought to have. Most enterprising and energetic business men want, and ought to want but ought not to get, more credit than they are good for. But if they got it, both they and their bankers would probably be sorry some day. When, as usually happens, they do not get it, they cry out against bankers as a set of stingy curmudgeons who starve enterprise. If there were no such criticism and all borrowers got what they wanted, it would be time to sell a bear of bank shares.

The price of these loans and advances to industrial and private borrowers used in former days to rule at 1 per cent. above Bank rate, with a minimum of 5 per cent. It was thus directly regulated by Bank rate only in times of dear money; and at all times specially favoured customers, especially in the days when competition was keen among a larger host of banks, were able to make special terms by a hint at the removal of their account. Lately with Bank rate generally ruling at 2 per cent., the 5 per cent. minimum, though still enforced occasionally, has had to be mostly abandoned, and the banks have had to take the best rates that they could secure, in com-

petition with insurance companies and other lenders who found themselves, in an era of cheap money and inactive business, with surplus funds to dispose of.

It may here be noted that the existence, often asserted, of a real gap in our banking machinery was confirmed by the final report, published in March 1929, of the Balfour Committee on Industry and Trade. While finding that on the whole the existing machinery for supplying British industry with financial facilities for meeting its legitimate needs was adequate and suitable, it called attention to the " suggested absence of any adequate means of financing long-term credits (say over a two- to five-years' period) in respect of the export of certain classes of capital goods, and the consequent difficulty in which manufacturers of such goods may find themselves, in comparison with their competitors in countries where it has been the practice for the banks to ally themselves closely with industrial enterprise and to give long-period credits."

In fact, however, some time before the Balfour Committee's report was published, this gap in our credit machinery was on its way to being partially filled, by the establishment soon after the war of the Export Credits Guarantee department of the Board of Trade. Originally confined to guaranteeing short-term credits against exports to certain specified countries, its business was later expanded to cover exports to all countries and for periods up to ten years. Since the London market was practically closed against foreign issues by an embargo first imposed by the Bank of England and afterwards reimposed by the Treasury—to say nothing of the scarcity of foreign borrowers with a record of solvency—these medium-term credits facilitated by the Export Credits

department have provided a valuable means of promoting exports of machinery and other kinds of capital goods to countries that needed them and could not, owing to the risk involved, be supplied with credit by private institutions. The department's access to world-wide official information, concerning credit conditions, trade prospects, etc., has also enabled it to render most useful service to its clients.

Most of its medium-term credits were for two to three years and its guarantee, which covered the risks of insolvency and of transfer, but not that of exchange fluctuations, which could be covered with dealers in forward exchange, was not usually given for more than five years. In 1936 a credit of £10 millions was given to Russia, on condition that it should be used for the purchase of goods the provision of which would promote employment in Britain, Russia paying interest at the rate of 5½ per cent. The department sold in the market, chiefly to the banks, at a premium which gave it a profit of about 3 per cent., Russia's five-year 5½ per cent. notes; and exporters working under the scheme received payment within thirty days of the shipment of the goods. It has also extended the scope of its activities by sending a representative to China to examine on the spot the possibilities of export credits for that country.

On June 11, 1937, Parliament was asked to sanction the abolition of the limitations on the date to which credits might be guaranteed, and to raise the limit on the total amount of the liability of the department from £26 millions to £50 millions. The Resolution was agreed to, in spite of criticisms uttered by Miss Ward, M.P. for Wallsend, who pointed out that the shipbuilding industry was unable to receive any benefit

from the department, and that some years ago when Poland wanted to build two trans-Atlantic liners in this country at a time when the shipbuilding industry was at its lowest ebb, the Government refused to grant guarantees because they did not want to increase the surplus world tonnage. The two liners were consequently built in Italy and were paid for by coal from Poland; and Italy had subsequently got further shipbuilding orders from Poland. More recently, Turkey placed, or tried to, orders for 15 vessels in this country, but owing to the refusal of the Government to grant facilities, these ships had finally been built in Germany. (*Times* report, June 12, 1937.) It was later announced that guarantees to shipbuilders, under certain conditions, might in future be considered by the department.

Our banks are also sometimes criticized for the inadequacy of the profit and loss figures that they publish and the veil that they draw across the amount of their expenses and the provision that they have to make for bad debts. But when claims are made that shareholders ought to be told all about losses and bad debts, we have to remember that the banks have very special reasons for reticence, because they live on the confidence of the public and the public is so likely to draw mistaken conclusions. Shareholders and depositors know all that they want to know, having complete confidence in those who direct and manage the banks, and knowing that owing to the long-established custom of accumulating hidden reserves—made possible by the reticence of which the critics complain—the position of the banks is generally much stronger than the figures show it to be. The real objection to the veil behind which banking does its business and the obscurity in which bad debts

are wrapped, is that their effect is to mislead many stupid people—and some very clever ones like Mr. Bernard Shaw [1]—into a delusion that banking is quite an easy job, which any Government official could tackle. Lending money with reasonable despatch and with a reasonable chance of getting it back again is, in fact, a business that requires a lifetime of training and experience. Nobody doubts that our Government officials, if they were caught young enough and were freed from red-tape fetters, could be taught to do anything, for they are very clever hardworking folk. But if banking were handed over to Government officials who have lived for years in the Whitehall atmosphere, referring everything to somebody else, the pace of enterprise and development would be likely to slacken.

If bank figures can throw any light on the state of trade, the more of such light that we can get the better, for our industrial leaders certainly want all the light that they can find. But on this point again bare figures may easily mislead. It is easy to ask why all the banks should not always, as a matter of course, give us an analysis of their advances such as Mr. McKenna furnished in the speech already cited. It would be very interesting, but would it enable us to draw safe inferences about the state of industry? A trade may need more credit if it is active, and likewise if it is depressed. On one point, however, Mr. McKenna did show us that useful light can be thrown by bank figures and that is by the separation of current from deposit accounts. He was able to demonstrate from the shifting of the Midland Bank's current accounts to deposit and *vice versa*, that the state of

[1] See the *Intelligent Woman's Guide to Socialism and Capitalism*, page 268.

trade is clearly reflected by these movements and that the proportion of "demand deposits," more usually called current accounts in this country, rises and falls with the activity of trade. Since this is so, and since some of the banks used to separate these figures, why should not they all do it regularly in all their statements, monthly and half-yearly?

CHAPTER VIII

THE BILL-BROKERS AND DISCOUNT HOUSES

(NOTE.—This chapter describes the functions of the discount market in the terms of pre-war experience, when it was a real market dealing in real bills of exchange by which the trade of the world was financed. One of its members has calculated, from the stamp revenue on bills of exchange shown in the Inland Revenue reports, that the average amount of foreign-drawn bills outstanding rose to £540 millions in 1928–9, sank to £134 millions in 1933–5 and rose to £138 millions in 1935–6. The figures for inland-drawn bills were £203 millions in 1928–9, £111 millions in 1932–4 and £121 millions in 1935–6. The market is thus now largely a "controlled institution" dealing chiefly in governmental promises to pay called Treasury bills, on terms more or less fixed. Now that Hitler's war, and the introduction of Treasury deposit receipts have made the Money Market more than ever a servant of the Government the following description of its pristine functions is still more out of date. But since it is just possible that a real market in real bills may some day be revived, and since in any case the original functions of the bill-brokers may be a matter of interest to the historically curious, I have retained most of the contents of this chapter.)
past tense, where necessary.)

WE have seen that the main functions in the manufacture of credit and currency are performed by the cheque-paying banks, and we have now to examine the operations of several minor but important subsidiaries, which the specializing tendency of civilization has called into being.

The banks manufacture money by making advances, that is, giving the right to draw cheques, against all kinds of security, by making investments and by buying or, according to the technical phrase, discounting bills, that is, giving the immediate right to draw a cheque or cash in return for an instrument which conveys the right to cash at a later date. The bill-brokers appear to have originally performed the function of intermediaries between the banks who were buyers of bills and the merchants who had bills to dispose of. This function they still carry on, though the Treasury now provides most of the bills handled, and, in so far as they remain bill-brokers, this is the chief part of their business. But several distinctions have arisen through the natural tendency to diversification of function, and it may now be said that there are roughly three classes of firms to be included under the titles which head this chapter.

(1) There is the bill-broker pure and simple, who devotes himself entirely to taking a parcel of bills from the merchants, accepting houses, foreign and colonial banks, and other chief agents, who receive them in batches by every mail, and selling them there and then on the best terms that he can obtain, receiving a commission for his pains, and for his knowledge of the market. This variety, which is the real survivor of the original bill-broker, is now comparatively rare. It is commonly described by the term "running broker."

(2) There is the retail dealer in bills, who is still generally called a bill-broker, but does not work on commission but buys bills outright, either from the running broker, or from the merchants and accepting houses, or from foreign correspondents, but never-

theless does not, as a rule, hold them himself until they mature, but sells them to the banks and other buyers, selecting the dates and classes of paper that the several buyers may happen to require. From the nature of his business, the retail dealer requires more capital and credit than the bill-broker pure and simple, because it may sometimes happen that his goods may remain on his counter for more or less time, until they happen to suit the fancy of a purchaser. His capital, however, is, as a rule, small when compared with the volume of his turnover, and he depends on credit, most of which is advanced by the banks, for the financing of the bills of which he daily remains the holder. It will be remembered that the banks habitually have considerable sums lent to bill-brokers "at call and short notice," and that these loans were described as their second line of defence, as being most easily called in. Their first line of defence, as need hardly be repeated, is their holding of "cash in hand and at the Bank of England."

(3) Out of the retail dealer in bills has grown the discount house, an institution which still does a certain amount of retail business, but is at the same time in a position, owing to larger capital and more extended credit, to "run a much bigger book," as the jargon of the craft would phrase it; that is, the discount house is to a greater extent a permanent holder of bills and depends in a minor degree on the momentary fluctuations in the price of credit. Nevertheless, the discount houses are very large users of borrowed money, and regularly announce rates which they allow to depositors, these being generally slightly above the rates offered by the banks. Owing to this fact, of the slightly better rate allowed by them, they generally

have the control of a considerable amount, placed on deposit with them by merchants and financiers, but at the same time, though their dependence on credit supplied by the banks is not as great as in the case of the retail dealer in bills, it is still sufficient to make a serious difference to their operations, whenever the banks have occasion to reduce their loans, or to charge more for them.

Having thus, for the sake of being perspicuous, classified and distinguished the three kinds of dealers in bills, we may proceed to eliminate the real bill-broker, the almost obsolete dealer on commission, and to apply the term bill-broker to the two classes who have grown out of him and are still called by his name, in accordance with the consistently illogical manner in which the City applies titles and descriptions.

As we have seen, the distinction between the other two classes is solely one of degree, the degree being the extent to which they hold bills permanently, and depend for financing their operations on credit obtained from the banks. At the head of the body stand some few private firms of old standing, great wealth and first-rate credit, side by side with two big companies which have applied the joint-stock system with considerable success to the business of dealing in bills, and an old firm which has now been joint-stocked. Under this leadership the market is compact and well organized. The business is one which once required exceptional abilities and alertness, and the rate of discount in London was perhaps the most sensitive and trustworthy barometer of international monetary conditions.

It was stated in the last chapter that the market rate was regulated by the Bank of England and the

banks; and we have now seen more clearly why this should be so, having found that the bill-brokers depend to a great extent on the banks both to supply them with credit and to buy bills from them. Nevertheless though the average level of the rate was thus regulated, the action of the bill-brokers themselves had an important influence on its daily fluctuations and so might make a considerable difference to the movements of the foreign exchanges.

In order to realize the complicated nature of the problem that had to be solved by a bill-broker whenever he bought or sold a bill, let us endeavour to enumerate some of the chief considerations which determined his judgment on the points that had to be borne in mind. We will suppose he was offered a line of first-class paper due in three months' time, the date being the last week in June in some pre-war year.

But first it will be necessary to try to get a clear understanding of the meaning of the terms in which the discount market expresses the conduct of its business.

We will suppose then that the bill is offered to the broker at 4 per cent., that is to say, that 4 per cent. per annum is the rate of interest which is deducted from the face value of the bill, which it will realize in three months' time, in order to induce him to give cash for it. In other words, he is asked to give £99 to-day for each £100 in the amount that he will receive on presentation of the bill on maturity. As the calculation of discounts is very puzzling to the uninstructed inquirer, perhaps it is better to be still more arithmetically elementary, and point out that as three months is a quarter of a year, the 4 per cent. per annum

is divided by four to arrive at the discount for three months, and hence it is that since the current discount rate is 4 per cent., we must knock £1 off each £100 of the bill's face value on maturity in order to arrive at its cash value on this basis. This rough calculation is only an illustration, of course, and the bill-broker, or his clerks, will work the problem out much more finely on the actual number of days in the bill. What has to be made clear is the fact that a bill is a security with a price, just like the stocks dealt in and quoted on the Stock Exchange, but that, instead of quoting the cash price for it, the market quotes the discount or the difference between its cash price and its face value on maturity. It is quite reasonable and simple when one thinks it out, that an instrument that will realize £100 in three months' time should only be worth £99 at the present moment, if 4 per cent. per annum be the current rate arrived at by the higgling of the money market. But the number of people who have never taken the trouble to work out this elementary but tiresome problem, and consequently flounder when they think or talk about the discount market, is a continual astonishment, and must be my excuse for giving so much space to a statement which is about as informing as $1 + 1 = 2$.

Another frequent cause of confusion in this connexion, though it also is dissolved by a moment's thought, arises out of the fact that the market is described as firm when discount rates go up, that is, when the price of the bill goes down. A firm discount market would result, we will suppose, in a rise in the discount rate from 4 to $4\frac{1}{4}$ per cent., and the result of this would be that the cash value of a bill with a year to run (for the sake of simplicity) would

fall from 96 to 95⅞. It is quite clear and reasonable that if money is more valuable the present price of a bill that will not mature for a year becomes less, because the buyer is giving immediate cash in return for the promise of cash a year hence. But to people who are accustomed to the expressions current on the Stock Exchange the notion of a firm market resulting in a fall in the price of the securities handled in it is often very confusing, for on the Stock Exchange, when they talk of a firm market, they mean one in which there is a strong demand for the securities handled by it and a consequent rise in prices. When the Consols market is firm Consols go up, when the discount market is firm bills go down, which is only another way of saying that discount, which is the commodity in which the market really deals, goes up.

All this is very platitudinous, but I have known an occasion on which a financial journalist was taken to task, by a man of high standing in the City, for stating in his money article that the discount market was weak, with easier rates, owing to the scarcity of bills. In this case a practical banker of many years' experience had fallen into this trap, so that I must be excused for giving a considerable amount of space to the endeavour to warn less well-informed inquirers against it. A moment's thought shows that when bills are scarce and in demand, buyers who want them will have to take them at lower rates, that is, at higher prices, so that the newspaper statement objected to was perfectly correct.

Having done our best to put a fence round this tiresome pitfall, let us return to our bill-broker, who was still wondering whether to buy a parcel of three-months' bills at 4 per cent. in the last week of June,

and let us examine a few of the principal factors that would determine his decision in pre-war times.

In the first place he had to consider the immediate circumstances of the market and the prospect of his being able to resell the bills forthwith at a profit, or to finance them comfortably if he be obliged to retain them.

The last week of June was a most unencouraging period from this point of view. The close of the two halves of the year are habitually marked by two processes, both of which severely restrict the supply of credit and of cash. In the last week of June and the last week of December an enormous volume of actual payments is made throughout the country, increasing materially the demands on all the banks for cash, and, at the same time, a large number of firms and companies, including some of the banks themselves, are making preparations for their half-yearly balance-sheets, that is to say, reducing credits granted to customers, and so increasing the proportion of their holdings of cash. As there is not enough cash to meet these two demands, it is nearly always necessary for the Bank of England to fill the gap; and in the period immediately preceding the turn of the two half-years it is usual for borrowers to go to the Bank of England and obtain credits with it for sums which sometimes amount to twenty or thirty millions or more. Part of these credits is used for the withdrawal of actual currency, for the cash payments that have to be made all over the country; the rest is left to the credit of the borrower—or someone to whom he transfers it—in the books of the Bank of England, and the financial community is thus enabled to show a fine round sum of "cash in hand and at the Bank of England," a credit

in the Bank of England's books being universally regarded as quite as good as, and much safer than, so many notes in the pocket.

Our bill-broker, of course, had no need to think of all this; it was all so well known to him that it was part of his being. But it was a very important factor in the problem that he was debating. For the first consequence that arose is the probability, or certainty, that he would be unable to resell the bills to the banks, or to other regular buyers. At such a season, the banks are most unlikely to increase the number of their bills, and will probably not even replace those that fall due and are paid off. They will have a considerable stock of bills in their portfolios bought with a view to the cash demands at the end of the half-year and maturing within this very week; and the maturity of this paper will be one of their weapons in providing the cash that they will require for their customers and themselves.

Since, then, the bills under consideration by the bill-broker will not be easily convertible into immediate cash, he is faced by the problem of having to finance them himself. And from what has been said above it is clear that during the next few days this is likely to be an expensive matter.

As we have already seen, the bill-brokers depend largely on a supply of credit from the banks for financing their business, and our friend had, in all probability, been already apprised by his bankers and other providers of credit that they had, at the present moment, other uses for their funds. For the advances to bill-brokers have been described as the banks' second line of defence, and when they wish to increase their first line, which is their cash in hand and at the

Bank of England, or to maintain it when it is diminished by their customers' demand for currency, they at once do so by calling in these loans to bill-brokers. So that far from expecting to be able to obtain the wherewithal, from ordinary sources, for financing the parcel that is offered, the bill-broker in question was probably already severely pinched in the matter of credit, and knew that if he took these bills he would have to borrow from the Bank of England in order to pay for them. And borrowing from the Bank of England was an expensive operation, since it usually charges, for advances, ½ per cent. above its official discount rate, which, again, is almost always well above the loan rates current in the outside market and does not lend for less than a week. (Lately, in order to keep money cheap and the discount market easy, it has been a common practice for the Bank of England to relieve the position at times of temporary scarcity by buying bills from the brokers through an intermediary, as explained on p. 194.)

So much for the adverse aspect of the immediate conditions. Against them we have to set the keenness of the seller, which induced him to offer an exceptionally fine parcel of bills at a rate which was tempting to the buyer, a high rate, that is to say, which means a low price for the bills; also the fact that as most buyers of bills were cramped in the matter of credit by the seasonal demands already alluded to, and so were not in a position to compete eagerly for them, it was a time in which the bold bargain-hunter, prepared to face the inconveniences of the moment, could often reap fine profits by the exercise of a capacity for disregarding immediate loss.

The forbidding appearance of the immediate con-

ditions thus works both ways. In order to take the bills the broker knew that he might have to borrow from the Bank of England for at least a week, and that the higher rate paid for this temporary accommodation would make a hole in the profit that he hoped to make on the bill during the course of its currency; but if future prospects were inviting he would be willing enough to do this, and it was the future prospect that would sway his decision.

And now the vastness of the problem really begins to open itself out, and our broker, if of an imaginative turn of mind, may well fancy himself like a doubtful partisan, standing on a hill-top and vainly trying to peer through thick mists, with the aid of a somewhat inefficient spy-glass, into a great plain in which a battle is being waged by a number of forces of shifting and incalculable strength, and knowing that his life depends on throwing in his lot with the winning side.

In the immediate future there lay the probability of a spell of cheap money, when the usual reaction took place after the satisfaction of the temporary demands at the end of the half-year, and after the distribution of the dividends on Government stocks early in July, which resulted in transferring to the hands of the ordinary banks some millions previously held by the Bank of England on behalf of the Government. These millions then became available at the market rate for loans, instead of at Bank rate, or ½ per cent. above it. After that, according to the normal tendency of the year's monetary history, the demands of holiday-makers and harvesters at home ought to begin to tell; while the great demand for currency all over the world, which generally showed itself during the autumn, when the crops of the chief agricultural

countries were being gathered and garnered and shipped to the consumers' markets, ought just to be showing its force during the latter period of the currency of the bills offered, so that their date of maturity should be happy, enabling the holder to replace them on favourable terms.

According to the normal behaviour of monetary events in pre-war days, the buyer of a bill at a good price at the end of June ought thus to be able to reckon on a short spell of ease during which he would be able to finance his purchase on very favourable terms—perhaps getting his money at 2 per cent. against the bill which we suppose him to have bought at 4 per cent. —and a gradually hardening tendency, which should not, however, reduce him to the necessity of giving more for his money than he was earning on his bill, or being obliged to sell his bill at a loss, owing to inability to provide the wherewithal to carry it.

But it need not be said that monetary events do not habitually move along the lines of normal behaviour, and even along these lines a little swerve in one direction or another might suffice to upset calculations that have to be reduced to the fine terms required by the keen competition of the discount market in London. The slackening of general trade might greatly reduce the demands of commercial customers on the banks and so throw a mass of credit back on them which they would pour out among the bill-brokers; a quickening of trade might have an equally marked effect in the other direction and upset all expectations of the spell of easy money which was to have made the holding of the bills a profitable transaction. A cold, wet summer will check holiday travel and expenditure, while a brilliant season will

send a shower of currency through tourists' pockets into the hands of hotel-keepers and others who provide for their wants; and the extent of this outward tide will be among the innumerable items that will affect the volume of what is called money in Lombard Street. The quality and date of the harvest is another matter that affects the monetary position, and in calculating its probabilities the weather has once more to be allowed for; for if at the harvest season something like an ideal English summer is reigning, and farmers think that they can rely on the continuance of favourable skies, they will proceed leisurely and gradually, and the supply of currency that they will require will be so much the less; but if the season is capricious, and a burst of harvesting weather arrives, everybody will want to save his crop at once, and each farmer will be pouring all the labour that he can get on to his fields and wanting money for wages, and for all the other expenditure that moving a crop entails.

And when he has balanced, as well as he can, the chances of trade, travel, and harvest requirements, the bill-broker must not forget the possible effects of an equally elusive factor, namely, the demands of Government finance; these used not, as a rule, to count heavily at the period during which the parcel of bills offered is supposed to be current; it was in the January to March quarter, when the income-tax is being gathered, that the money market was habitually pinched by the transfer of cash to the Government's balance at the Bank of England; but throughout the year it was always possible that the Treasury would intervene with some unexpected demand in the shape of an issue of Treasury bills, or, on the other hand might make money unexpectedly plentiful by

allowing its balances to run below their normal level. For owing to the fact that the Bank of England is the Government's banker, the Government's money is in its hands, and consequently when the Government holds an unusually large sum, there is so much locked up, and not available in the outside market. Since the war the existence of a huge floating debt, handled by the Treasury and the Bank of England, has given, as we shall see, these Olympian powers an immensely strong hold on the money market, though it has also obliged them to ride the market with a very gentle hand on the curb, and continually to pet it and pat it.

And as if weather, trade, and Government finance were not sufficiently incalculable factors in the problem, there arises the purely psychological question of the possible extent of speculation on the Stock Exchange. We have seen that the banks, which supply the bill-broker with money, employ a considerable amount of the credit that they make and handle, in financing the requirements of those who buy stocks and shares and pay for them with borrowed money. Consequently, if an unusually large number of people come to the conclusion that a purchase of securities with borrowed money is likely to be profitable, the supply of money available for the bill-broker may be curtailed. And the reasons which suddenly impel the public to indulge in one of its periodical outbursts of speculation are, perhaps, as complicated a psychological problem as anybody could ever be asked to solve.

And yet we are still only on the threshold of the bill-broker's difficulty.

For all these things happened, or did not happen, at home and more or less under his own eye, and when he

proceeded, as he must, to consider the possibility of foreign demands, he was face to face with questions which were much more difficult to answer and much more important in their effects. The movement of currency into the country for harvesting and holiday purposes, or the piling up of the Government's balance at the Bank, or the demands, arising out of an unexpected outburst of speculation, might cause inconvenience, and perhaps, if their effects were particularly unanimous and untoward, make a serious difference to the profit on a bill: but a sudden foreign demand and a considerable export of gold might, in gold-standard days, be followed by a complete alteration in the whole aspect of the market—a rise in Bank rate and a readjustment, for the time being, of the value of credit at home and abroad.

Having devoted so much space to the consideration of the bill-broker's problem and having discovered that we have only touched the surface of it, it seems wiser on the whole to leave him with his problem and our sympathy. For any attempt to enter in detail into the innumerable causes which affect the demand for money abroad would lead us into a discourse of most formidable area.

But it may be mentioned incidentally that the risks of foreign politics and of international friction, the mere hint of which was often sufficient to affect the sentiment of the money market, were among the items in the enigma which had to be solved, or guessed at, by our bill-broker before he arrived at his decision. And it need not be said that any serious shock to credit occurring in any part of the commercially civilized world might easily upset all his calculations.

It is not, of course, implied that all these matters

were actually revolved by a bill-broker before he made up his mind about any of the numerous transactions which make up his day's business. If this were so, the work of the discount market would never get itself done. But they, and many more, were the data on which he had to work, and a rough-and-ready view of the balance of all these possibilities and hypotheses had to be at the back of his head somewhere in his subconscious intelligence.

The essential difference between him and the banker lies in the fact that the banker makes credit, while the broker sells credit, relying on being able to buy it cheaper. The conditions most favourable to the broker are a high discount rate, which is the price of the credit that he sells, and a low rate for money, or short loans, which are the credit that he buys. The broker has need of keen and sensitive alertness as opposed to the level-headed sagacity, which is the most necessary asset of the banker. But the most important feature in the position of the bill-broker is that he constitutes the second line of the banker's defence, and consequently first feels the effect of any monetary pinch. If money is wanted suddenly by other customers whom bankers think fit to oblige, or if it is thought necessary to restrict the supply of money, the advances from bankers to bill-brokers are likely to be straightway curtailed. And this is an additional reason which makes a large supply of alert and open-eyed intelligence so necessary for his success.

CHAPTER IX

THE ACCEPTING HOUSES AND FOREIGN BANKS

(NOTE.—Also a description of functions now more or less in abeyance, but capable of revival.)

IT ought by this time to be clear, unless the proportion of the perspicuity of this work to its tediousness has been most lamentably inadequate, that what we call money generally means credits with a bank, and that most of these are created either out of loans or investments made by the bank or by some other bank, or by the discounting of a bill, which is only a special form of loan.

Further, the bill has been shown to have advantages over any other form of security, because the shortness of its currency ensures a speedy return of his cash to the holder, and because it is drawn, or ought to be, against actual produce moving into consumption, so that, as is claimed by those who deal in it, a good bill of exchange pays itself.

It will also be remembered that the original bill of exchange was an order drawn on the purchaser of the produce by the seller, instructing him to pay its price to himself or some other party at the end of a period during which the purchaser might be expected to have disposed of the produce, either in its original form or worked up for consumption by some process of manufacture. And the purchaser of the goods accepted the bill by signing his name across it—that is, acknowledged that he would be liable for the sum

named at the due date, and so became the acceptor of the bill. After which the bill, drawn by a good name and accepted by a good name, and with the necessary documents in order showing that goods had been duly shipped and insured, was as sound and attractive a security as the most sceptical money-lender could require, and could readily be discounted and advanced against.

It is necessary to pick up these threads which we left flying loose when we turned from the consideration of the forms of money to that of the principal wheels in the machine which produces money. Of these we have found that the banks are the chief, since they provide the right to draw cheques, which are the currency of English commerce, and give credits against indebtedness, which is called into being by the fact that trade habitually lives on the profits which it is in process of realizing, and could not proceed with its present unceasing velocity if it had to wait for their realization before it went on to its next task. Next we examined the operations and responsibilities of the bill-brokers, the retail dealers in bills, who are, as it were, an offshoot of the banks specializing on the selection of bills to suit the requirements of the bankers as to date, etc., and keeping them in stock with the assistance of credits chiefly furnished by the banks. It is now necessary to consider the functions of those who manufacture the bills, against which the banks and discount houses jointly or severally provide credits.

In describing the bill of exchange in Chapter IV we took the simplest possible case in order to keep the ground as clear as might be of confusing obstructions, and imagined an American farmer, Mr. Silas

P. Watt, selling wheat to a London merchant, Mr. John Smith, and drawing a bill on him for the value of the produce. By so doing we not only attained a measure of clearness which would otherwise have been impossible, but also got down to the ultimate facts of the case. For the real manufacturers of real produce bills are still the grower of the produce and the merchant who handles it in its ultimate market. Without them the produce could not come into existence, and without produce there could be no bills, except of the kite-flying order, as drawn by Mr. Micawber on Mrs. Micawber.

Nevertheless, modern processes of specialization have introduced certain intermediaries between the producer and the merchant in the ultimate market. As matters are arranged now Mr. Watt would sell his wheat to a merchant in his own country, and it would probably pass through many hands on paper before it was finally shipped. It would be financed in the meantime by advances from American banks, and the bill drawn against it, when finally shipped, would be drawn by an American bank or finance house on its correspondents in London, who would be a firm devoting much if not most of its time and attention to this specialized industry of acceptance.

Since this inquiry is confined to the machinery of money in London, we can leave out the producer and the American merchant and their bankers and confine ourselves to the London end of the bill, that is, the London name which is written across it, and so marks it as accepted.

It is easy to understand how a distinct class of accepting houses grew up out of the merchant importers who originally accepted bills in the course of

their importing business, that is, accepted orders on themselves to pay for goods which were in process of being forwarded to them. The readiness with which the acceptances of the different merchants would be discounted and turned into cash would vary considerably with the difference in their reputation and standing, and the caution with which they were credited in the matter of conducting their business. And the varying readiness with which certain acceptances were discounted would inevitably express itself in varying rates at which their bills could be placed. It would thus naturally follow that it would profit merchants of second-rate standing to give a commission to those whose reputation was more exalted in order to secure a more attractive signature than their own, and so get back the commission and a little more by being able to finance their operations more cheaply than by means of their own acceptance.

The merchants of first-class credit would thus find that they could let out the use of their reputations on profitable terms, and proceed to specialize in this branch of business, which consisted in examining the bills put before them for acceptance, keeping themselves well acquainted with the means and standing of the drawers of them, and giving their acceptance, for a commission, to such paper as fulfilled the requirements of their discrimination.

The foreign connexions arising out of the original trading operations, with which they laid the first foundations of their mercantile position, naturally led these houses into providing monetary accommodation for the governments of the countries with which they traded, and there thus grew up out of the ranks of successful City merchants a class of merchant bankers,

financiers and accepting houses, which, along with the old private banking houses, constituted a sort of aristocracy in the City, which still survives to some extent. They are often described as merchant bankers, but it is important to remember that they are not bankers in the strict sense of the term, (see *ante*, p. 83) because it is from their ranks that the directors of the Bank of England were chiefly recruited, and it used to be a rule that a director of the Bank of England must not be a banker.

The importance of the function of the accepting house need not be emphasized. If the producer of the produce is the original creator of the bill, it is the acceptor who, by his signature, gives it currency and hall-marks it for the purposes of the London market. A banker or broker who discounts a bill and parts with cash or credit in exchange for it, cannot be expected always to know the position and trustworthiness of the drawer, and must often rely on the name of the acceptor as his sole guide in appraising its merit. So that it is by the judicious and properly regulated use of their names that the accepting houses put into circulation an enormous mass of credit instruments, the supreme merits of which as liquid investments have already been insisted on with " damnable iteration."

Nevertheless, the office of the accepting houses is still dependent on that of the banks, because the bills that they accept, though thereby greatly furthered in their progress towards becoming cash, do not actually become cash until they have been discounted. And this is done either by a banker or by a bill-broker who works with credit, generally furnished to him by a banker. A bill that cannot be discounted is of no

use to the holder until its day of maturity, and is not until then a credit instrument in any sense. And we thus come back once more to the supreme importance of the banks in London's monetary polity.

For the power of the accepting houses to give currency, by their acceptance, to paper concerning the merits of which they are best in a position to discriminate, is one that is obviously liable to dangerous abuse, and in their case the check of publicity is absent, since the private nature of their business keeps it free even from the ceremony of a half-yearly published balance-sheet. A very little carelessness, a very little error on the side of optimism, and a very little neglect of the principle that the basis of a real bill should be real produce moving into consumption and there are all the materials for a dangerous inflation of credit. And the banks, which ultimately provide the means by which acceptances are turned into cash or credit, have thus an important responsibility thrown upon them, and one which is not apparent to the general public, to which the whole machinery of acceptance is more or less a mystery.

The question is complicated by the fact that, as has already been mentioned, the banks have themselves undertaken the business of acceptance to an extent that has increased rapidly in recent years. The excellent sanity with which the banks conduct their business makes this complication more apparent than real; and the dependence of the accepting houses on the good opinion of the cheque-paying banks concerning their paper is modified by the fact that they can ultimately have recourse to the Bank of England, through a bill-broker. The Bank of England requires two British names, of which one must be the acceptor's,

on bills that it discounts, and a bill accepted by a British firm and endorsed by a London bill-broker fulfils its requirements. And the Bank of England has before now intervened with effect when the paper of an accepting house has been unreasonably considered too plentiful by the other banks.

Nevertheless, the opinion of the banks concerning the paper of an accepting house is very important to it; and the position is curious which makes the banks at once the watch-dogs over the volume of acceptance, and large, increasingly large, acceptors themselves. It is possible that, in order to attract customers and increase other kinds of business, the banks sometimes give their acceptance too cheaply, and it is natural that the accepting houses should regard their expansive intrusion with an unfavourable eye. It is also very essential that the banks should remember that the least irregularity or carelessness on their part in the selection of the paper that they hall-mark with their acceptance might have very far-reaching effects, if it came to light and were the subject of City comment, because the general body of their customers and depositors would be extremely likely to misunderstand it; and that what would be a mere indiscretion in an accepting house, which does not depend for its existence on the confidence of the uninstructed multitude, might mean disaster to a bank, which does.

At the same time, if watched over with due care, the growing interest of the banks in acceptance business seems to be a perfectly natural process arising out of the increasing requirements of the expanding trade of the world. It is difficult for the ranks of the old private accepting houses to be recruited; it had lately been done with success, when this book was first

written; but a firm that enters on the business has to have capital and credit at its command, such as are rarely to be found in the hands of folk who are prepared to risk them in a new enterprise, the technicalities of which have to be acquired with patience, and perhaps through costly experience. The extent to which the old houses can accept is restricted by the obvious limits which are imposed on the amount of business, especially of business in credit, that can be done by any one firm. And the reputation and position of the banks seem to qualify them naturally to fill the gap.

An important part of the machinery of acceptance is also furnished by the Indian and Colonial banks, which, naturally again, give a large part of their attention to providing exchange between London and the country with which they are connected, and to handling the paper which its trade calls into being. The high reputation of the Indian banks, and the skill with which the bills endorsed by them were marketed, made the prices fetched by their bills often a leading factor in the quotations of the discount market.

Finally, in considering the main springs which feed the flood of acceptance, we come to the London agencies of the chief Continental banks, which in pre-war days played a very important part both as sellers and buyers of bills. Since the closing of the German banks' London agencies owing to the war; bills drawn on foreign bank agencies are much more rarely seen. But this only meant that credits which used to be raised in London on foreign account by drawing a bill on a German bank's London agency were raised by drawing on a London bank or accepting house. The volume of credit provided for foreign borrowers

was probably greater than ever, before the recent contraction of international trade.

Foreign financiers were quick to detect the advantages of the English credit system, and to turn them to their own profit and to the furtherance of the trade of the countries that they represent. It is often contended that the rapid expansion of German trade, which pushed itself largely by its elasticity and adaptability to the wishes of its customers, could never have been achieved if it had not been assisted by cheap credit furnished in London, by means of which German merchants ousted English manufactures with offers of long credit facilities to their foreign customers.

But all the controversy that used to rage on this point and on the alleged difficulty experienced by British exporters in supplying long-term credits to their customers is an echo of a past in which international trade was active, and before it had been shattered first by the war and then, when it was slowly picking up the pieces, by the after-effects of the war as shown on p. 78. The collapse of the American gamble, the shutting up of American lending and the consequent collapse in commodity prices leading to poverty and bankruptcy among the primary producers and the Governments which lived by taxing them, combined with economic nationalism and political bitterness and apprehension to reduce the flow of international trade to a miserable trickle; and the authorities of the leading nations are still talking with more vigour than acting in order to restore it. Fortunately, however, it shows signs of reviving in spite of economic nationalism, thanks to increased purchasing power distributed by the higher prices of commodities.

In the meantime, the establishment and rapid growth

of the Export Credits Guarantee department has partially filled a gap in our credit machinery and so is a step towards solving some of the problems of British exporters, both old and new. Among the new ones is a host of restrictions on the transfer of money from one country to another, which was formerly carried out by means of the market in foreign exchange, the next subject that has to be tackled.

CHAPTER X

THE FOREIGN EXCHANGES

(NOTE.—In this chapter I have retained examples of the working of the exchanges under the gold standard, before they were influenced and controlled by intergovernmental contracts, adding a postscript on the Exchange Equalization Funds which have now more or less taken its place.)

THE foreign exchanges are really a fairly simple matter if we keep them free, as far as possible, from the technicalities which are the delight of experts in the subject, who generally expound it. They were exemplified in Chapter I by the purchase of a postal order, and they may be described as the mechanism by which money here is exchanged for money somewhere else. In the example there given the business was simplified by the existence of the machinery of the Post Office, which is prepared to undertake exchange transactions at fixed rates.

In the exchanges of the large amounts which international commerce makes payable in one place or another, the bill of exchange plays an important part. But the essential point to be grasped is the fact that fluctuations in rates of exchange are caused by variations in the relative value in the currencies of the two centres between which the exchange is quoted. If Londoners have big payments to make in Paris, or want to send large sums to Paris, they will want to exchange many pounds for francs, and the value

of the pound will be depreciated when expressed in francs, and the Paris exchange will move "against London." The most obvious reasons which will cause this variation, or stimulate this demand in London for remittances to Paris, will be the balance of trade in its widest sense—the exchange of commodities and all kinds of services between England and France—and the rate of interest ruling in the two centres. If Paris sells more goods and services to London, people in London will have larger payments to make in Paris; and if the rate of interest be 3 per cent. in Paris and 2 per cent. in London, money will tend to flow from London to Paris to earn the higher rate, and the demand for remittances to Paris will thus be further stimulated.

Since bills of exchange play an important part in this business of the exchanges, it is perhaps safer to repeat here that a bill of exchange is an order by A directing B to pay a sum of money to himself, A, or to a third party; that the cheque with which you tell your bank to pay £2 to your butcher is, in fact, a bill of exchange; but that the term, in its more usual meaning, implies an order on a person at some distance in space to pay a sum at some distance in time. As, for example, when a dairy farmer in New South Wales sells butter to a produce merchant in London, and draws a bill on him at sixty days' sight. When the bill is "accepted"—that is, when the merchant acknowledges his liability to pay by writing his signature across the bill—it becomes a negotiable instrument and can be discounted and turned into cash.

It can also, evidently, be used wherewith to pay any debts that the farmer may have to meet in London. If he owes a similar sum to his harness dealer, he

can hand the bill over to him and let him collect the money from the merchant; and the one bill will thus have paid two debts. It has paid the farmer on behalf of the produce merchant, and the harness dealer on behalf of the farmer. Or if the farmer owes money in other parts of the world, a bill on London is always acceptable; if he has bought hay-making machinery in America, the draft on his merchant could be used equally well to pay for it, for there would be plenty of people in the United States who have payments to make in London and will give a certain number of American dollars to the manufacturer of mechanical hay-makers for his order on the London merchant.

And here comes in the difficulty which makes the foreign exchanges apparently so obscure. When it was a matter of a payment between London and Sydney, there was no question of a difference of currency, for in both these places the pound sterling was the unit in which payments were expressed. But when a draft on London has to be sold in America, the relative value of the pound and the dollar comes into the calculation. And the unfamiliar observer is puzzled by the fact that these relative values continually fluctuate, with the result that the table of exchange quotations constantly varies, and the exchanges are said to move in favour of or against a particular country in a manner which is very extraordinary to him, since the intrinsic value of the currencies that they represent is unaltered.

We shall arrive at a clearer understanding of the matter if we leave out for the present this question of exchange of different currencies and return to that of the exchange between London and Sydney, as it

worked in the pre-crisis days, when these two towns used notes of the same gold value as legal tender and as money of account. (Since then the Australian pound has been devalued more than the pound sterling.) It might therefore be supposed that anyone who had to make a payment of £20 in Sydney would have to put down in London exactly £20 plus a payment to the colonial banker who sold him the draft for his trouble and expense in sending the money.

But this was not so. Owing to the fact that Australia constantly had to remit to England in order to meet interest on debt, etc., the Australian exchange tended to be in favour of England; that is to say, a credit on London was more sought after in Sydney than a credit on Sydney was sought after in London, because the drain of money was habitually from Sydney to London.

Hence, if you went to an Australian bank's London office and bought a draft on Sydney with your cheque on the Westminster Bank you were giving it money in London in exchange for money in Sydney, and we have seen that money in London was relatively more valuable than money in Sydney owing to the exchange being normally in favour of London.

Consequently, the Australian bank was prepared not indeed to give you an order for £20 and something over in Sydney in return for your London cheque for £20, but to do what comes to the same thing, namely, manage your remittance for you for nothing, making no charge for its trouble.

But if the movement were reversed, and someone in Sydney were buying a draft on London, he would have to pay £20 plus a premium, because the exchange was in favour of London; that is, a pound in

London normally commanded more than a pound when compared with a pound in Sydney.

Here, then, we have an example of the working of the laws of exchange between two countries in which the coins into which drafts are convertible were identical, and if once we can grasp the logic of this, we have gone a long way towards simplifying the more complicated question of the exchanges between countries with different currencies.

For the broad principle is the same everywhere. Whenever, for any reason, one place, A, has to send more money to another place, B, than B has to send to it, B's currency will be relatively more valuable, and the exchange will be in favour of B.

Let us consider the matter again in the case of Sydney and London and suppose that instead of going to one bank to arrange your remittance you went into a regular market wherein were assembled representatives of many Australian banks and exchange dealers, and waving your cheque on the Westminster before them asked them, in the gold-standard days, how much money in Sydney they would give for it. If the pressure to remit money from Sydney to London were keen, they would all be eager to have your London cheque, because by buying it in exchange for a draft on their Sydney balance they would be increasing their London credit at the expense of their Sydney credit without incurring the cost and risk of sending coin or bullion from Australia.

Consequently competition would impel them to give you something more than £20 in Sydney, but that something more would be limited by the expense of sending coin and bullion. If we suppose, for the sake of simplicity, that expense to be covered by 6*d*. per

pound, it would pay them if the demand were eager enough to give £20 10s. for your London cheque. Beyond that it would not pay them to go. If you tried to insist on £20 10s. 1*d*. it would be cheaper for them to send gold from Australia. So that in this case £20 10s. (or £1 0s. 6*d*. per pound) would represent what was called gold point, and if your London cheque really fetched that price, the exchange between London and Sydney would be said to have gone in favour of London up to gold point, and the movement of gold from Sydney to London might be expected to begin.

In the case of large amounts, and of places far distant, the element of time becomes important. If exchange between London and Sydney were at par, it might still pay an Australian banker to give more than a pound in Sydney for a pound in London because he would receive the pound in London at once, and his balance in Sydney would only be drawn on five weeks hence when the draft arrived. So that he would have the use of your money for five weeks, and in times when the rate of interest is high this is an important consideration.

In the example just considered, where the exchange between London and Sydney was strongly in favour of London, it was supposed that a pound or a pound's worth of credit in London might fetch £1 0s. 6*d*. in Sydney. If the tendency of the balance of indebtedness were flowing in the other direction, and there were a great demand for drafts payable in Sydney, London's currency would be depreciated as compared with Sydney's, and a pound here might only fetch 19s. 6*d*. on the other side. But in the time of the gold standard this depreciation could only work up

to the point at which it would pay those who have debts to pay in Sydney to pack gold and send it rather than make use of the machinery of exchange. If you were offered only 19*s.* in Sydney in exchange for your pound here you would obviously inform the dealers in exchange that you preferred to dispense with their services, and would ship gold to your Australian creditor.

Restating the matter yet again in the effort to be clear, we may express it by saying when the sums that people want to send from Sydney to London are greater than the sums which have to be sent from London to Sydney, the Londoners will be in an advantageous position, and able to buy drafts on favourable terms: but that the amount in Sydney that their pounds or cheques representing pounds in London will fetch could not rise above the exact equivalent plus the cost of remitting gold from one centre to the other. When that point was reached the exchange was at gold point.

What was called the mint par between the two places was in this case the pound, and if the cost of remittance, insurance, etc., be 6*d.*, as we have supposed for the sake of simplicity, the outside fluctuation of the exchange will be 1*s.*; for if it cost Sydney over 20*s.* 6*d.* to buy a pound in London, Sydney would ship gold to London rather than buy drafts; and if a pound in London fetched less than 19*s.* 6*d.* in Sydney, Sydney would import gold from London.

We can now proceed to consider the question as it appears when the balance of indebtedness is being settled between two countries which use a different currency.

In France the unit is the franc, so that when a

Frenchman wants to send money to London he wants to exchange francs into pounds; conversely, an Englishman who wants to send money to Paris has to exchange pounds for francs.

The value of the new (but not the latest) franc, established by M. Poincaré in June 1928, was "fixed at the weight of 65½ milligrammes of coined gold at 900 fine, which places it on a par with sterling at 124·21." [1]

The cost of sending gold from one centre to another varies from time to time according to the rate of interest current (because money on the way is not earning its keep), changes in freight charges, packing charges, etc. There is no such thing as a fixed "gold point" at which it pays better to send gold than to buy a bill. In 1929, however, if you shipped gold to Paris, your pounds, by the time they made the journey, would realize about 123*f.* 85*c.* Consequently, if you could buy a bill on Paris at any higher rate it would pay you to do so rather than send gold.

Whether you would be able to do so would depend on the value of money in Paris as compared with London, and on the balance of indebtedness between London and Paris. If the rate of interest were higher in Paris than in London, London would want to send money to Paris to earn the higher rate, and if Paris had been selling us more valuable goods and securities and services than we had been selling to her, Paris would have more bills on London arising out of those sales than London had on Paris; consequently, the demand in London for bills on Paris would be keener than the demand in Paris for bills on London, because London had more remittances to make.

[1] *Economist*, June 30, 1928, page 1335.

Hence it would follow that the seller of a bill on Paris would be able to get more favourable terms, and the exchange would be, as it is called, in his favour; in other words, his francs would be relatively more valuable than the pound, and the pound would fetch less when expressed in francs. And if the balance of indebtedness were heavy enough, and the competition of those who wanted to buy drafts on Paris—that is, to exchange pounds for francs—were keen enough, the value of pounds expressed in francs would go below *124f.*, and then those who had remittances to make would begin to think about shipping gold instead of buying drafts, the Paris exchange having gone down towards gold point.

When the balance was the other way, and London had been selling more valuable goods and securities and services to Paris than Paris had been selling to London, bills on Paris would be more plentiful than bills on London, and the French importers of goods, etc., would have to compete for drafts on London in which to make their payments. That is, they would have to pay more in francs, which would be relatively depreciated, for the pounds that they needed for the payment of their debts, and their competition would force the exchange up towards the other gold point, when shipments of the metal might be expected. But it must not be forgotten that the relative value of money in the two centres was a constant influence which might increase or modify the movement of exchange due to the influence of indebtedness for goods and services. If London had sold large amounts of goods to Paris, but money was dear in Paris, the two influences would tend to counteract one another; London would leave the proceeds of its sales in Paris

to earn the higher rate of interest, and as long as it does so those sales would not affect the exchange.

It may have been noted that the French exchange is against London when it is low and in London's favour when it is high. And this is natural and inevitable when we consider that the quotation expresses the value in francs which a pound will fetch. When this value is low the holder of a pound receives less in francs, and so the exchange is very literally against him. When you want to buy francs with your pound, the more francs you get for it the better it is for you. When the rates of exchange are quoted in English money, it is otherwise. The Argentine dollar is quoted in pence. When it rises from 48$\frac{1}{4}$*d.* to 48$\frac{3}{4}$*d.* it moves against England, because it fetches more pence, and anyone who wants to exchange pounds for dollars will receive less of them. This is one of the small complications which make the question of the exchanges so difficult to the inexperienced. But it can always be met by considering that the ultimate fact expressed by rates of exchange is the relative value between a pound and a foreign currency. When the pound buys more of the foreign currency the exchange has moved in our favour; when it buys less the exchange has moved against us.

It thus becomes evident that the foreign exchanges are a mechanism by which international indebtedness is settled between one country and another, and that rates of exchange are the prices at which the currencies of the various countries are expressed relatively to one another. When the balance of claims between two places did not roughly agree gold used to be shipped to settle the difference, unless it could be met by what is called arbitrage, which consists of dealings

in bills on other centres. For instance, London might not have enough claims on Paris to set off the claims of Paris on it, but might be able to fill the gap with bills on Berlin, or some other centre, which Paris might happen to want.

The system on which the exchanges work is thus similar to that of the bankers' Clearing house in London. In it the claims of the clearing banks are crossed off against one another, and any balance that is due, for example, from the Westminster Bank to the Midland, is settled by the deduction of part of the Westminster's credit at the Bank of England and its addition to the Midland's. But in the case of international indebtedness, the balances used to be settled by shipments of gold. Such, at least, was the theory of the matter, though the restrictions that most of the chief Continental centres used to place on withdrawals of gold often prevented, or at least postponed, the working of the machinery of exchange in accordance with theory.

The broad principle which has been thus set forth and exemplified was the ultimate basis of the movements in the rates of exchange between all countries, even those which had currencies based on different metals, or in the case of those in which the currency is based on nothing but the printing-press. But it need hardly be said that there could be no gold point in the case of countries with a currency which consisted of silver or of inconvertible paper notes. Nevertheless, even in their case, though the fluctuation of exchange was complicated by variations in the price of silver or by new issues of paper currency, yet the balance of relative indebtedness between them and other countries was still an important factor, ready to assert its com-

plete predominance at any moment when other complicating influences ceased from troubling.

Since, then, it is largely on the mutual indebtedness of various countries that rates of exchange are based —though we must not forget the influence of the rate of interest in the various centres—let us see how in normal times this mutual indebtedness arises.

The most obvious cause of it is the mutual exchange of natural produce and manufactured articles—the balance of trade, as it is generally called. This we see chronicled in the monthly returns issued by the Board of Trade of British imports and exports. These always show that England has imported goods of much greater value than those which she has exported, and because there is no published record of her other exports —her invisible exports, as they are sometimes called— superficial observers are often very much frightened about the state of English trade and draw astonishing inferences, the most notable of which was propounded by a colonial premier who told an English audience that England had to export annually so many millions of golden sovereigns to pay for the balance of the cost of her imports over that of her exports.

In fact, an "unfavourable" balance of trade, which is the misleading description given to this condition of the purely commercial relations between one country and another, is one that may be shown either by countries of the highest economic development which are in a position to supply other countries with credit and other services, which the other countries have to pay for with their goods; or by countries at an early stage of development, which are borrowing abroad and supplying themselves with goods and equipment in exchange for promises to pay.

At the same time, those who are alarmed by the extent of the difference between the value of our visible exports and imports are justified to this extent if they consider that it is better for England to be a manufacturing country than a creditor and banking country. A large part of our invisible exports consists of services rendered by the clerking and financing classes, and those critics of our trade position who do not ignore them, but maintain that they would prefer to see them replaced by goods worked up by the producing and manufacturing classes, take up an attitude which is perfectly logical. The more common course, however, is to ignore these invisible exports altogether, as was done by Mr. Seddon in the speech referred to above, and to deduce the alarming conclusion that we are living on our capital, and otherwise in a terribly decadent and deplorable condition, from the commercial point of view.

This being so, though it is an oft-told tale, it is perhaps worth while to enumerate some of the invisible exports by means of which we fill the big gap between the values of our imports and exports of visible goods.

During 1928 we had an excess of imports of merchandise and bullion amounting to £359 millions. On the other hand, we exported the following "invisible" items:—

(1) Shipping freights. Our ships were estimated to have earned £130 millions by carrying goods for oversea customers.

(2) Interest coupons. Our estimated net income from overseas investments was given by the Board of Trade as £285 millions, and was suggested by the *Economist* to be £300 millions.[1]

[1] *Economist*, March 2, 1929.

(3) Insurance facilities. The English insurance companies and firms do a large business all over the world, and draw thence a regular income in premiums.

(4) Banking facilities. The large sums spent annually by Americans in Continental travel are, to a great extent, financed by drafts on London, on which London takes toll. Still greater, probably, is the profit that England regularly makes by discounting bills for other countries, financing their speculations by carrying over shares for them in the London market, and making advances in other forms.

(5) Pleasure, social amenities, titles, and art treasures. Americans in times of prosperity spend a constantly increasing amount in travel and enjoyment in England. Many of them, it is said, are anxious to cut a figure in what is called Society, and the lavish expenditure in which they indulge is believed to be of some assistance to this ambition. All this expenditure here on their part has the same effect on the balance of Anglo-American indebtedness as an English export. It is also well known that the scions of ancient English families frequently find wives among the attractive daughters of America, and the big dowries that the latter bring with them amount to a considerable annual charge on the United States. The habit of purchasing art treasures, lately rife among rich Americans, is another item in the balance. The fact that owing to American tariff regulations many of these art treasures are left here does not, of course, interfere with the effect on international indebtedness produced by their purchase.

(6) Family affection. Many of the English, and especially Irish, settlers in America and elsewhere, regularly remit sums to their parents and families

at home, taking nothing in return but affection and gratitude. Everyone who has read *Some Experiences of an Irish R.M.* remembers the picture of McCarthy, the horse-dealing farmer who charged Mr. Bernaid Shute £45 for a mare, saying, " She's too grand entirely for a poor farmer like me, and if it wasn't for the long weak family I have, I wouldn't part with her for twice the money." The long weak family was explained by Mr. Flurry Knox to be " three fine lumps of daughters in America paying his rent for him."

The above list might be continued, but sufficient examples have been given to show that there are many more exports in heaven and earth than are dreamt of by the philosophy of the monthly Board of Trade returns. It must not be supposed that the movement of these items is all in one direction. Foreign ships carry English goods, foreign insurance offices do business in England, and Englishmen spend money on travel and sport abroad. But it is estimated—and all these matters must be to some extent a matter of guesswork—that our total income in 1928 from these invisible items was £508 millions—leaving us with a balance after paying for our excess of visible imports of £149 millions to be added to our investments abroad.

For 1936 we had an excess of imports amounting to £347 millions, and a debit item of £2 millions for excess of Government payments abroad. But owing to the trade depression our invisible exports, though showing some recovery from previous years, were far below those of 1928. The Board of Trade estimates put shipping income at £95 millions, income from overseas investments at £195 millions, and other items at £40 millions, making a total of £330 millions and leaving an apparent adverse balance of £19 millions.

If this result was correct, we had lived on our capital —which means that our debtors were paying off their debts to us—to the tune of nineteen millions; but the *Economist*, in its issue of February 27, 1937, observed that there was reason to believe that some of the items on the credit side had been underestimated.

It need not, of course, be supposed that the final balance, after allowing for all exports and imports, visible and invisible, must be exactly equal between any two countries. It is perfectly possible for one country to be normally indebted to another year in, year out, on this balance of trade in its widest sense, and yet to be in a perfectly wholesome economic condition, being kept so by being in a contrary relation with some other country. It will thus be able to meet the bills drawn on it by its creditor with those that it draws on its debtor, and thus the sum of mutual indebtedness is crossed off and cancelled all over the world, or met, when at any time the supply of bills is inadequate, by movements of bullion in gold-standard days to settle the balances.

This case arose, for example, when the chief agricultural countries were reaping and moving their crops. They held, for the time being, the manufacturing countries in fee, and they needed gold for the actual circulation of currency or as the metallic basis of paper currency. And, consequently, when gold movements were normal, gold used to move to the United States, Egypt and Argentina in their harvesting seasons.

It is in these cases that the utility arose of the practice, referred to in earlier chapters, of drawing bills in anticipation of crop movements. Without this arrangement, countries whose staple export was harvested at a certain season would take payment

in gold for it at that season, and would, during the rest of the year, have to remit in gold for the goods and services that it bought from other countries. But the dealers in exchange, and the more legitimate class of finance bill, provided the means by which, at times when such a country had nothing to export, the exchange dealers would make good profits by creating bills against nothing, but in anticipation of the crop that is in the ground, with the result that the country exported less gold in its off seasons, and imported less when its crop was ready. Its imports of machinery in July were paid for by semi-fictitious remittances, created by exchange dealers who drew finance bills and so raised credits, and these bills were met later by the shipment of the country's crops in September, and by the bills genuinely drawn against them. And so the clumsy necessity for sending gold backwards and forwards across the oceans was reduced, though not extinguished.

It need not be said that it is quite impossible to gauge exactly the amount and value of the invisible commodities, which, as above enumerated, have so important an effect on the balance of international indebtedness, and so on the foreign exchanges. And one of the most elusive of the influences which thus complicate the question is that of the purchase and sale of securities between one country and another. But it has to be considered now because it is closely connected with the main question dealt with in this inquiry.

When one country raises a public loan in another, everybody is well aware of the transaction, and there is no difficulty about the matter. For example, Brazil borrows three millions in the London market by

an issue of 5 per cent. bonds. The issue is advertised and subscribed, there is an open market in the bonds, and it is all clear and above-board. Brazil has exported to England three millions' worth of its promises to pay; England has returned to Brazil three millions' worth of money or credit, or the right to draw on London, either by taking gold or by using its credits here to cancel debt elsewhere, or to make any purchases required. The immediate effect of the transaction will be to turn the exchange in favour of Brazil, though it must always be remembered that the overt working of this effect may be veiled by other influences. During the currency of the loan the effect of its existence will be to turn the exchange in favour of London, because Brazil will be obliged to remit periodically to meet the quarterly or half-yearly interest payments and the service of the sinking fund established to extinguish the loan gradually by purchase or drawings of the bonds.

Hence it is that no debtor country—that is no country which has borrowed extensively from the investors and money-lenders of other countries—can afford the luxury of what is called an unfavourable trade balance. In order to meet its interest payments and its sinking fund arrangements, it must (unless it does so by borrowing a bit more) habitually ship more goods than it receives, since the lenders are continually sending it interest coupons and drawn bonds, the payment of which it has to provide for either with goods or with fresh borrowing.

In other words, what is usually called a favourable trade balance may generally be taken as a sign of the economic dependence of the country which possesses it.

The same effect on the exchanges is produced when

the borrowing is done, not by the Government of the borrowing country, but by companies; as, for example, when the Pennsylvania Railroad sold £4,000,000 bonds here, the operation for the moment turned the exchange in favour of the United States, but during the currency of the bonds produced a periodical claim by London on New York for interest payments. Nowadays, however, the Pennsylvania raises any money it wants at home.

These public issues of loans are potent and obvious influences on the exchange. But an equally important effect, which is difficult to trace, is produced by the purchases of securities made by the investors of one country in the Bourses of another.

It is the natural tendency for a debtor country, as it makes economic progress, to buy up gradually the securities on which it has borrowed from others, and so to reduce or extinguish the amount that it has to provide abroad for interest payments. For example, Italian Rentes, the public debt of Italy, were formerly largely in the hands of foreign holders in France, Germany and England. Italy, in the period before her Abyssinian adventure, achieved considerable economic progress. She had developed her internal resources with great success, and she had been assisted by the possession of an inexhaustible asset which she exports continually, or rather lets other people come and enjoy. For Italy holds the world in fee as an exporter of Beauty—beauty in scenery, beauty in atmosphere, beauty in buildings, sunshine, association, and a hundred other things, besides her art treasures, which it would be absurd to call priceless, because to think of price in connexion with them would be a vulgar irrelevance. Every year an increasing number

of travellers from all lands poured into Italy to see these things, bringing circular notes and other forms of drafts wherewith to pay their way; and, in order to meet these drafts and to feed the balances with their Italian agents on which they are drawn, the other countries had to send Italy goods, or services, or securities. Thus Italy has been enabled to buy up a large proportion of her own securities which were formerly held by foreign investors. Consequently, she had largely relieved herself of the drain against coupons, and her exchange moved rapidly in her favour. So much so that pre-war travellers in Italy who had not been there for some years used to be astonished to find how much less valuable the English sovereign had become when measured by its exchange price in Italian currency.

These purchases of securities by the investors of one nation in the Stock Exchanges of others were a constantly fluctuating element, which had a marked effect on the balance of national indebtedness, and was and is extremely difficult to trace or gauge. Equally so was the perhaps still more important element provided by the shifting from one centre to another of the more highly specialized forms of securities, chief among which was the bill of exchange. And when we arrive at the ebb and flow of this restless ocean we come to the point at which the foreign exchanges most obviously affect the main subject of our inquiry, and it begins to be clear that this attempt to explain them was by no means an irrelevant infliction. For the movements of bills of exchange from one centre to another depended to a great extent on the rates of discount respectively current in them.

If the rate of discount was relatively low in London,

bills would be poured in from abroad to be discounted and turned into cash here, and foreigners would use their credits here, and draw bills on London and discount them; and so our imports of securities would be increased, and the exchanges would be turned against us. And if the exchanges were against us, and gold was being taken from London, this state of affairs was remedied by a rise in the rate of discount here, which checked this import of bills and impelled foreigners to remit funds to London to be employed in the purchase of bills; and if the process was continued, we began to export securities, and thus turn the exchanges in our favour. And so we begin to see the great importance of the market rate of discount, owing to its effect on the foreign exchanges and through them on the ease or difficulty with which our supply of gold was maintained.

We have thus arrived, through the thorny labyrinth penetrated in this chapter, at a description of the working of the exchanges in gold standard times which may be summarized thus:—

The foreign exchanges are the expression of international indebtedness.

International indebtedness is the balance arising from the exchange between countries of goods, services, and securities. The movement of securities, especially of bills of exchange, depended largely on the discount rates current in the chief financial centres.

The discount rate had thus an important bearing on the foreign exchanges.

It has also been shown that when the foreign exchanges went to a certain point, gold would be taken from London, because, for example, it would pay better to send gold to Paris than to take only 123*f.* 85*c.* (or

whatever the gold point of the moment may be) for one's pound on 'change.

So that we are now beginning to see more clearly the importance of the market rate of discount, and the need for its sagacious regulation in times when the relative prices of money in different centres are an important influence on its movements from one to another.

The market rate of discount depended, on the one hand, on the supply of money, and, on the other, on the supply of bills of exchange which came forward to be turned into money. We have already examined the chief parts of the machinery which creates and handles money and bills of exchange—the banks, bill-brokers, and accepting houses—and we found that in normal times the supply of money and the level of discount rates are regulated by the banks, and especially by the Bank of England.

Such were the problems and working of foreign exchange in the days of the gold standard as it ruled in pre-war times and tried to rule, after being generally restored in 1925, until it collapsed in 1931. When England was forced off it, and the pound had dragged its golden anchor, the British Government set up an ingenious machinery for its protection against too wide fluctuations and the embarrassing attentions of speculators. In the Budget of 1932 powers were taken to borrow £150 millions to form the working capital of an Exchange Equalization Fund and this amount was raised to £350 millions in 1933 and to £550 millions in 1937. By the sale of Treasury bills the Fund provided itself with the necessary supply of pounds sterling, which it sold to foreign buyers at times when their purchases were forcing up the exchange value of the pound too quickly. The foreign currencies that it

acquired in exchange for the sterling sold, it is believed usually to turn into gold, which can be used at any time, if necessary, for the support of sterling against undue depression. It operated through the exchange brokers and through them it kept itself informed as to the state of the market.

A similar Fund was set up later by the United States, and later still by France and the other survivors of the gold-standard countries when in the autumn of 1936 they finally submitted to its surrender. Apart from the control that it exercised over temporary fluctuations, the British Fund did not interfere in any way with the ordinary business of exchange dealing; still less has its existence altered the working of the causes which, as described above, influence the movements in rates of exchange. It and its foreign imitators may modify the extent of these movements for a time and flatten out seasonal fluctuations; but cannot prevent in the long run the depreciation of a currency which, owing to mistrust or trade influences, is, for a long enough time, less wanted than others.

Under the gold standard, fluctuations in exchange were limited by the gold points. Now they are limited only by the power to control them held by those who manage Exchange Equalization Funds, and by the extent to which they think fit to exercise this power of control. The secrecy with which their operations are surrounded involves dealers in exchange in a good deal of brain-racking guesswork about the possible intentions of the regulators of their market and add another uncertainty to the business problem, already complicated, in this connexion, by the restrictions imposed in many countries on the transfer of money to foreign creditors by their citizens.

CHAPTER XI

THE BANK OF ENGLAND

EVERY schoolboy knows, and most grown-up people have consequently forgotten, that the Bank of England was founded in 1694 to finance William III's Government. Since its foundation it has been the keeper of the national balance and the channel through which the nation has conducted its financial operations.

Its notes are the only form of paper currency that is legal tender in England, that is to say, that has to be accepted in payment of a debt, and it is the only joint-stock bank which is allowed to issue notes in London. As we have seen, the advantages possessed by the cheque have enabled it to supplant the note as circulating currency, but the Bank's privileges in the matter of note issue undoubtedly were of great service to it in its earlier history, and were an important cause of the prestige which, until its failure to maintain the gold standard, made its name a household word for stability and soundness throughout the civilized world. It may also be presumed that they were an indirect cause of the fact that now gives the Bank its source of greatest strength and importance, namely, its position as the bankers' bank.

It has already been shown that the Bank of England's privilege in the matter of note issue in London was

intended to give it the monopoly of joint-stock banking in London, and that the flank of this monopoly was only turned when it was discovered that note issuing was not an essential part of banking. The result of this discovery, instead of weakening the Bank of England by the creation of a host of nimble competitors, strengthened it by providing it with a number of enterprising and wealthy customers, who developed banking facilities all over the country in a manner which would have been impossible to it without a radical alteration in its machinery and constitution, left with it the cash balances that were not required for their till money and country reserves, and so not only increased its dignity and visible strength, but made its task of financing the Government simpler and cheaper, reducing it to a great extent to a matter of entries in its own books.

For see what happens when the Government has to pay its dividends on War Loan and other Government stocks, and finds itself in need of ten millions or so for this purpose. It borrows ten millions from the Bank of England, and the Bank of England gives it a credit for this amount in its books, against which the Government draws its dividend warrants. But only a small fraction of this amount is actually withdrawn. For the most part the warrants are paid into the other banks to the credit of their customers who hold War Loan, and are paid in by them to the Bank of England to the credit of their balances with it. So that instead of making a great provision of cash the Bank only has to set its clerks to work with their pens rather faster than usual, and the thing is done. Thus two of the principal duties of the Bank of England, its management of the Government's money matters

and its custody of the other banks' balances, fit into and assist one another very aptly.

Equally simple is the Bank's still more important task of providing emergency currency, and again for the same reason, the fact of its being banker to the collective banking community. In all economically developed communities there are periods when the normal supply of cash is insufficient, as, for example, at harvest time in agricultural countries and at the ends of the quarters, when everybody has to pay his rent and meet other periodical demands, and especially in this country at the end of the two half-years, when a large number of firms and companies all over the kingdom draw up their balance-sheets and strive to show a fine proportion of cash in their assets. And at the end of the December half-year these demands coincide with a big movement of actual currency into circulation to provide for Christmas travelling and money paid over tradesmen's counters for Christmas presents and the material ingredients of Christmas jollity. Consequently, at these periods there comes a seasonal demand for what is called money, and the Bank of England, by reason of being the bankers' bank, is able to provide it with extraordinary ease and expedition.

For money in England, as we have long ago recognized, chiefly means a credit with a bank, carrying the right to draw a cheque. In so far as it means pocket-money in the form of notes, the problem here is the same as elsewhere, and the periodical withdrawals of these for the cash payments alluded to periodically affect the Bank's reserve. But the great proportion of the seasonal demands are met by cheques, and a large part of them, those arising out of the desire

to show large cash holdings in balance-sheets, are for ornamental purposes, and are only wanted to impress shareholders and customers.

Hence it follows that a large proportion of the emergency currency required at the end of the quarters is created for show and not for use, and is borrowed from the Bank not to be withdrawn or passed on, but so as to figure in balance-sheets included among "cash in hand and at the Bank of England."

We thus arrive at an important distinction between the credits given by the Bank of England and those of the other credit-making banks. When the latter make an advance against any kind of security or buy stock for investment, they create a deposit and give a right to draw a cheque, which is probably exercised; the cheque drawn transfers the customer's credit to the customer of some other bank, and, as we saw in Chapter V, the loans of one bank create the deposits of another, except when the loans are raised with one bank for repaying another. But in the case of the Bank of England, its position as the bankers' bank results in any credits that it makes for its customers being left with itself, having been transferred from one bank to another in its books; and, what is still more important, the credits that it makes rank as cash for the rest of the banking world, so that the demand for cash for ornamental purposes in balance-sheets can be satisfied with remarkable ease by book entries. And thus banking development has outwitted and eluded the well-meant effort of the Legislature to guide and regulate it.

The Bank of England's monopoly of note issue which was intended to give it the monopoly of joint-stock banking in the metropolitan area, was nullified

by the discovery that note issuing was not the most important part of banking, and yet some years after this discovery had been marked by the foundation of the joint-stock banks, which are now, collectively, the Bank of England's biggest and most important customer, the Legislature passed an Act which elaborately regulated the note issue of the Bank of England as if its note issue were still the central feature of its business and the only thing which merited the consideration of parliamentary wisdom.

It will be remembered that the Bank Charter Act of 1844, or Peel's Act, as it is sometimes called, laid down the principle that the amount of notes issued by the Bank against securities should not exceed the sum of £14,000,000 unless by the surrender of the note-issuing privilege by other banks, which exercised it, of course, outside the circle of the Bank of England's monopoly. Any more notes issued were to be based on metal held in the Bank's vaults.

The Bank Charter Act thus proposed to revolutionize banking by taking away from the Bank of England the right of allowing it to judge for itself of the proportion between cash and securities that it held on the assets side of its balance-sheet against the notes issued on the other. "Your securities," it said in effect, "are to remain as they are, and for every extra £5 note that you issue in future you shall hold £5 in coin or bullion."

As to what might have happened if the Act had worked in the manner intended by its promoters, is a matter of interesting but idle speculation. Banking evolution has evaded or avoided the question by the development of a habit of regarding a credit in the books of the Bank of England as just as good as so

many bank-notes or sovereigns or bars of bullion. Borrowers do not, as a rule, ask it for notes, but for a credit in its books, which it can create to an extent that is limited only by its own discretion.

By means of this system emergency currency and credit are provided with extraordinary ease. It has grown automatically, commands complete confidence, and works with a perfection that no theoretically planned scheme can excel. If the supply of money runs short, borrowers come to the Bank of England with securities of the kind that it approves, and in the course of a few minutes' conversation with the principal of the discount office add a million or two to the basis of credit as expeditiously and easily as the ordinary citizen can buy a pair of gloves. The machine is a miracle of ease and efficiency.

The result, as it appears in the published statements of the Bank's position, is merely that the Bank of England shows an increase in securities on one side of the balance-sheet—these being the securities against which it has made advances—and an increase in deposits on the other; and the popular habit of gauging the position of a bank by the amount of its deposits would lead hasty observers to the gratifying conclusion that some fresh mass of accumulated wealth had been stored up and deposited at the Bank, and that it and its customers were richer than ever. Really all that has happened is that the Bank of England has lent "money" to some more borrowers, and, being banker to the other banks, has been able to do so by making a book entry, instead of seeing the "money" taken away from it in the shape of notes or coin.

Actually, of course, the Bank of England's position has been, when strictly considered, weakened by the

operation, because the increase in deposits is an increase in liabilities, and the increase in liabilities without an increase in cash necessarily means that the proportion between cash and liabilities has been lowered, and the proportion between cash and liabilities is the most obvious touchstone that is first applied to the position of a bank in considering its apparent strength. And this question of the cash brings us to what was, in the gold-standard period, the Bank of England's other most important function—that of acting as keeper of the gold reserve for the rest of the banking community.

This function, it is interesting to observe, also arose out of the fact that the Bank of England is banker to the other banks. They, by keeping their balances with it, have, as we have seen, greatly facilitated the readiness and despatch with which the Bank finances the Government and creates emergency currency; but, at the same time, they had imposed on it this heavy burden and responsibility of maintaining the ultimate reserve, and the Bank of England was never able to forget that its liabilities are not as the liabilities of other banks, since they contain that big block of bankers' balances, which the other banks regard and treat as cash, and use as part of the basis for the soaring structure of credit that they build up.

The obligation and responsibility were all the more onerous, because they have arisen, as it were, as an unsuspected irrelevance, and were long unrecognized and unacknowledged. It might have been thought that when the Bank Charter Act of 1844 had definitely laid down the duty of the Bank of England with regard to its note issue, all that it had to do was to carry out its legal responsibility with due punctuality and, for

the rest, to carry on banking business on ordinary banking lines.

This, in fact, was the view long entertained by an influential section of the Bank's Court of Directors, and its fallacy was exposed in that most brilliant of all essays in practical economics, Walter Bagehot's great work on *Lombard Street*. Bagehot not only exposed the fallacy, but killed it, buried it, and damned it. To do the Bank Court justice, it should be mentioned that even those of the directors who maintained it in theory did not advocate its practice, but spoke of a 33 per cent. cash reserve as adequate, though the ordinary banks would regard such a proportion as extravagant. In later days, even the theory had been abandoned, and the Bank of England had so effectually recognized the gulf that separates it from other bankers that it normally showed a proportion of cash to liabilities that was more than twice as large as that shown by those of the other banks which are strongest in that respect. In other words, the Bank might, if it reverted to the theory that it was only one bank among many working on the same principles, have doubled the amount of its liabilities with a corresponding increase in its investments and dividends without altering the amount of its cash.

It is true that the greater part of the Bank of England's cash reserve in the banking department consists of its own notes issued by its issue department. But these notes are secured according to the provisions of the Currency and Bank Notes Act, and the other banks, with the practice of which we are now comparing the Bank of England's, include in their cash not only Bank of England notes but credits in its books.

But Bagehot's brilliant criticism of the manner in which the Bank recognized its responsibilities was chiefly concerned with its handling of the demands brought upon it by internal crises, and in days when an internal crisis meant a demand all over the country for Bank of England notes. Since its publication the position has been modified in two important respects. In the first place, the development of the use of cheques and of book-entry credits has been so great that it may fairly be inferred that at least the early stages of an internal crisis need not have much effect in the shape of a demand for notes. It is, of course, possible, that a panic might arise in England so severe that members of the mercantile community might refuse to accept one another's cheques in payment of debts and that we should take a temporary step backwards to the exclusive use of Bank of England notes. In that case the situation would have to be met by a suspension of the Bank Act in the old-fashioned style, the temporary abrogation of the limits imposed by it on the Bank's freedom of action, and the unlimited creation of notes to meet the demand. But apart from actual general cataclysm it seems reasonable to expect that any gap in credit might probably be filled by a mere enlargement of the Bank's advances, and a consequent increase in the credits which it gives to other credit-makers to serve as a basis for their operations. In other words, instead of the Bank's reserve being depleted by internal panic, it might have the effect of merely increasing its holding of securities and its liability under deposits, as normally happens at the end of the half-years.

In the second place, the problem that the Bank of

England has to face is much more external than it seems to have been when Bagehot wrote. Except during a few days in August 1914, when the shock of war upset all the money markets of the world and drove most of them to the printing press for shelter, our machinery of internal credit has worked so well and smoothly, that the possibility of real internal panic is almost forgotten. On the other hand, the general adoption of the gold standard by the economically developed countries of the world, accompanied by the fact that London was for a long time the only market in which every draft and every credit were immediately convertible into gold as a matter of course, greatly intensified the responsibility of the Bank of England as custodian of a gold reserve, which, when the gold standard was effective, was liable to be drawn on at any time from all quarters of the habitable globe from which a draft on London may be presented.

For a long time before 1914 the difficulty of this task that it had to perform was increased, if not created, by the fact that it had in normal times little control over the extent to which these credits in London were granted. For here again we find that the other banks were once more ultimately responsible, just as we have seen that they are now chiefly responsible for the creation of a mass of internal credit and currency, which they build on the foundation of the Bank of England's reserve, but expand at their own discretion and at rates which, in pre-war times, had no connexion or sympathy with the official rate that was named by the Bank. By the bills that they accepted, discounted and lent against, by financing the bill-brokers, and by advanc-

ing against Stock Exchange securities, the other banks gave foreign financiers a pull on the Bank of England's reserve, and the Bank of England was expected to maintain it. This responsibility was shared by the accepting houses, which by accepting for a foreigner, created a bill which he could discount at the Bank of England through a bill-broker, and so gave him credit which he could convert into gold.

Owing to the extent to which banking facilities had been developed outside it, the Bank of England's official rate was often a quite empty formula, and the business of the London market was carried on without any relation to it; and herein is another point in which the pre-war money market differed from that described in Bagehot's *Lombard Street*, for we find Bagehot constantly assuming that any change made by the Bank of England in its rate would at once affect, and be followed by, those current in the open market. "At all ordinary moments," he writes, "there is not money enough in Lombard Street to discount all the bills in Lombard Street without taking some money from the Bank of England." In pre-war times this was no longer true. The Bank, in order to make its rate effective, often had to take special measures—considerably developed since then—of a kind which will be described later.

At present let us recapitulate the work that the Bank of England has to do, and then briefly consider the organization by means of which it faces its responsibilities.

It keeps the balance of the British Government and manages its finance.

It keeps the balances of the other banks, which treat their credits in its books as equivalent to cash.

It provides emergency currency at seasons of stringency, by expanding its book-entry credits and so increasing the amount of this so-called cash.

It keeps a cash reserve which is more than twice as big as those of the other banks which are strongest in this respect.

In the time of the gold standard it kept the central gold reserve of the one of the few money markets in which any form of credit instrument was immediately convertible into gold, and so had to be ready for any emergency that might arise anywhere, making somebody with a credit in London determined to take away its proceeds in the shape of metal.

Its advantages and responsibilities were thus evenly divided. Its acting as banker to the Government gave it prestige which was invaluable, conveyed the impression that it always had the Government behind it, and often produced the notion that it was a State institution, which it only became in 1946. And its holding of the balances of the other banks enabled it to lend money to Government and to create emergency currency by a mere transfer in its books. On the other hand, since the bankers use their balances with it as cash and as the basis of the credit that they make, the Bank of England has therefore to see to it that the reserve against these balances is not exposed to the demands of too many other customers; and hence the relatively high proportion between its cash and liabilities, which tells heavily on its power to earn dividends. This obligation of maintaining a relatively big cash reserve was formerly increased in intensity, and made more difficult in execution, by the fact that the Bank of England held the central gold stock of one of the few free markets in gold in the world, and

had to be prepared to meet at any moment demands on it that might come forward from abroad, and had been rendered possible by credits given by its credit-making customers, or created by accepting houses in the shape of bills discounted with it through a bill-broker.

Having thus reviewed the Bank of England's responsibilities and privileges, difficulties and advantages, let us see what kind of machinery and organization it brings to bear on its problems.

Momentous changes in these matters have been carried out in the last twenty years. In 1908 I wrote that the Bank

> is like no other bank in the world, and its eccentricities begin before you have crossed its threshold. Its external appearance, which its inhabitants and frequenters take as a matter of course, makes the country visitor gape with wide-mouthed wonder; one of them, on learning to his surprise that it was not Newgate Gaol, accounted for his error by saying that he thought it must be a prison because it had not any windows. Except where pierced by windows over the main entrance, the Bank's external walls are all solid, but of course it is part of its business to be among other things a fortress, capable of resisting physical attack by needy gentlemen too eager in the interests of the better distribution of wealth. It has done so before now, as everyone knows, because the story of the Gordon Riots is told not only in history books but in *Barnaby Rudge*. Even more obvious and impressive is the low level of its roof, and the fact that this big block of space in a spot where ground is worth so much a foot is covered by a building most of which consists of vaults and two stories. An enterprising American, viewing sadly this waste of an invaluable site, remarked that if that old bank had a live President, he would run up twenty floors on the top of it, make ten times its dividends as a real estate company, and not bother any more about the mouldy old banking business.

Internally it boasts spacious courtyards and a garden full of brilliant bloom and green leaves, in seasons when such things are possible, making a most effective and restful contrast with the grim grey walls, the roar of traffic outside, and the jingle of gold that can be heard occasionally from the big hall in which notes are being cashed. It also contains a certain amount of consecrated ground, part of its site being an old churchyard. Hence it was that an unfortunate giant, who was also a clerk in the Bank, fearing that his seven feet of skeleton would be too valuable a prey for the body-snatchers to miss, got himself buried within the Bank's walls in the vain hope that his bones might there rest in peace. Not many years ago some workmen making alterations in the vaults came on a gigantic human jaw-bone; it was sold to a dentist, who proudly exhibits it to patients, and so the giant's fears have been partially realized.[1]

When we come to consider the Bank's organization, its most striking features are the constitution of its Court of Directors, and its system of government by rotation, and these are points on which the Bank's critics have fastened with the keenest energy and determination.

The Bank Court is a committee recruited chiefly from the ranks of the accepting houses and merchant firms, and its members are nominated by itself, subject to the purely formal confirmation of the shareholders; and it is an unwritten law that no banker in the ordinary sense of the word, that is, no one connected with what we call the cheque-paying banks, can be a member of it.

At first sight this is one of those anomalous absurdities so common in England, and so puzzling to the intelligent foreigner, who cannot understand why we suffer them. A Court of Directors ruling the Bank of England, and so performing most important banking functions, and yet disqualifying for membership anyone with an expert knowledge of banking, is a tempting subject for an epigrammatically minded satirist. But in fact this anomaly, like many of our others, not only works excellently well in practice, but is, when calmly considered, clearly based on sound common-sense. For in the first place it would obviously be undesirable that a member of

[1] F. Straker, *The Money Market*, ch. ii.

one of the outer ring of banks should have the insight into the position of his rivals which membership of the Bank of England Court would give him, unless all the others were similarly privileged. But if all the outer banks were represented on the Bank Court, it would become a committee of unwieldy dimensions, perhaps reproducing or reflecting in the Bank parlour the rivalries and jealousies that stimulate the outer banks to work against one another, but are not conducive to their working together. And the question of proportionate representation would be difficult to settle. As it is, the Bank Court, being free from connexion with the outer banks except by keeping their balances, is able to watch their proceedings with a wholly impartial eye, and, on occasion, to make suggestions with salutary effect.

Moreover, the functions, already described, that are performed by the Bank of England, are obviously different in many important respects from those fulfilled by the outer banks. Its chief customers, the Government and the other banks, are so special in kind that the custody of their funds has to be approached from a special point of view, and the Bank's duty of maintaining the gold reserve by regulating the ebb and flow of the international bullion stream is a problem for which the ordinary banker's training would be of little assistance, and for which the Bank's directors are obviously better qualified, owing to the closer touch with business affairs abroad, which arises from their connection with the accepting houses and merchant firms.

Nevertheless the narrowness of choice that limits the Bank Court in selecting its new members is certainly one of the drawbacks of its organization, and its difficulty in finding fit recruits tends to increase owing to the changing conditions of modern business. Some widening in the sweep of its net seems to be desirable, and will doubtless be brought about by the alertness that the Bank has shown in recent years in adapting itself to alterations in its environment. As an example of this alertness it may be mentioned that the Bank was one of the first institutions in the City to adopt female clerical labour on a considerable scale.

More genuine are the objections to the rotatory system by which the Governor of the Bank holds office for two years,

having previously served for two years as Deputy Governor, and then—so say the critics of the system,—just at the time when he has mastered his duties, retires into the obscurity of the Committee of Treasury, which is composed of members of the Court who have "passed the chair." Apart from the objection already noted, one result of this system is that a Bank director is not likely to become Governor until he has been many years a member of the Court. Consequently the new members of the Court have to be chosen when young, in the hope that in twenty years or so they may be capable Governors, and this is sometimes a matter of perilous hazard.

It cannot be denied that the system by which the Governor is put into the chair is somewhat fortuitous. Nevertheless, it has its advantages. The Committee of Treasury represents a body of experience which is always at the Governor's service, and the periodic tenure of office makes the Governor more inclined to lean on the experience and suggestions of his colleagues on the Court, and of the heads of the various departments, and to be less a self-sufficing autocrat than he would probably become if he held office permanently, as is often proposed. And it is very important that the ruler of the Bank of England should be amenable to, and express, the broad common-sense of the commercial community as a whole, and not the prejudices and convictions of any individual, however gifted. But it is not the purpose of this work to enumerate and examine the many proposals that have been made for improving the constitution of the Bank of England. Subjected to the test of results, it shows a record that is not only unrivalled, but unapproached. For no other institution in the world attempts even to face the problem of being always ready to carry out the immediate conversion of any draft on the centre of which it is the head, which is cheerfully and composedly undertaken by the Bank of England. The elasticity of the English system, which works with the Bank as its centre, is the envy of the world, and any alteration, however slight, in so delicate a machine as a credit system, might have effects which were not at all intended.

Since 1908 the alertness of the Bank in adapting itself to alterations in its environment, then noted,

has had plenty of opportunities of expressing itself and has worked hard. Its outward appearance is in process of alteration by the building of a lofty edifice which will largely replace the old two-storied fabric, though the original outside walls are to be religiously preserved, in spite of the claims of a street-widening project. The old garden has vanished and gone is the old front courtyard across which, according to tradition, lines used to be drawn to guide the footsteps of Directors, in the jovial days of old, after audit dinners.

In the composition of the Court of Directors an equally striking expansion has been effected. No longer confined to the members of the accepting houses and merchant firms, it was recruited by additions from a wide circle, including Eastern bankers, an ex-official of the Treasury, the late Sir Basil Blackett, and that mighty worker Sir Josiah Stamp, railway chairman, economist, statistician, moralist and building society president, and—perhaps the most radical change of all—by the appointment as Deputy-Governor first of Sir Ernest Harvey and then of Mr. Catterns, both of whom had been Chief Cashier. Another former holder of that post, Sir Gordon Nairne, was also made a member of the Court, having first filled a newly created office as Comptroller. Later additions, made in 1937, were Mr. John Martin, chairman of the Rand Mines company and formerly president of the Transvaal chamber of mines, and Mr. Bunbury, some time a governor of the Imperial Bank of India. The latter, and also Mr. Holland-Martin, a scion of one of the oldest private banking families in the City, marked another new departure by doing whole-time work as "executive directors," performing, among

other things, much of the detail tasks once done by the Governor in times when international and other preoccupations claimed less of his attention.

An impressive succession of theoretical advisers was added to the staff, beginning with Dr. Stewart, formerly statistician to the Federal Reserve Board at Washington, who was followed by Dr. Sprague, a distinguished Harvard economist, and afterwards, when a *liaison* officer from America was less necessary, by Professor Henry Clay, a well-known English writer on economic subjects. Other advisers furnished the Bank with information on the problems and conditions of the Dominions and Colonies. Two ex-Treasury officials have drawn still closer the bonds that link Threadneedle Street with Whitehall.

But it is in the position of the Governor that the most notable change, in the eye of the general public, has happened. That Lord Cunliffe, as he afterwards became, who held office when the Kaiser's war began, should go on holding it until 1918, the last year of the war, was evidently fitting; but it was generally supposed that this breach in the system of Governors with a two years' life was just a war-time event. And when his successor, Sir Brian Cokayne, afterwards Lord Cullen of Ashbourne, resigned in 1920, it seemed that the two years' rotation had been restored. But since then, Mr. Montagu Norman held unbroken sway until 1944, when, as we shall see later, he was succeeded by Lord Catto. In the meantime everyone admits that Mr. (now Lord) Norman set the whole financial world a fine example of disinterested and tireless energy; and that he, working in double harness with the late Mr. Benjamin Strong of the Federal Reserve Bank of New York, carried out a task of quite incal-

culable benefit to the world at large in the difficult after-war years. When the politicians were still talking strife and making ugly faces and ugly gestures, these two men got the financial world to see that reconstruction and co-operation were the needs of the moment, and worked like Trojans to put Europe on its legs again. Their success would have been greater and less short-lived had it not been that while they were helping the shattered nations to stabilize currencies and issue reconstruction loans, and getting them to work together, the politicians were putting up and raising trade barriers, shouting to their deluded publics that it is bad for one's country to buy foreign goods, and engaging in political manœuvres which made real peace impossible, and opened the way to Hitler's war.

CHAPTER XII

BANK RATE AND MARKET RATE

BANK rate is the official *minimum* rate at which the Bank of England will discount bills. It differs from the market rate of discount in that it is normally higher, and in that it is not a constantly fluctuating rate, shifting with the supply of and demand for bills, but is fixed and announced every Thursday morning at a special meeting of the Bank Court, and except under most unusual circumstances is not changed on any other day. But the fact that it is only the *minimum* is occasionally enforced in practice, if the Bank finds that too many bills are being brought to it for discount; on such occasions it sometimes refuses to take bills except at a higher rate, which usually becomes the official rate on the following Thursday. For loans and advances the Bank usually charges ½ per cent. more than for discounting bills. When the Bank is discounting bills at the official rate, or making advances at or above it, Bank rate is said to be effective.

It should be noted that the official rate only rules at its head office, and there only partially. The Bank of England discounts at the market rate for private customers at its head office and also at its branches; in fact, according to the frequent complaints of the other banks, it used to compete with them in the

country by under-cutting in the matter of rates in a manner which annoyed them seriously, and with some reason. Here again the Bank had been elbowed into a very difficult position by the force of circumstances. Its branches were never a spontaneous creation, but were founded by it largely in answer to a demand for them in the country which arose out of special and temporary conditions; when the industrial and agricultural centres had been enmeshed in a network of banking facilities, the branches of the Bank of England remained, and necessarily made some exertion to justify their existence. Hence very natural grumbling on the part of the other banks, which said that the Bank of England took their money and used it to underbid them in their own territories.

Since this old grievance has been abolished or forgotten, a new one has been found in the support alleged to have been given by the Bank of England to certain foreign and semi-foreign institutions, which it has been accused of spoon-feeding in a manner that was unfair to their English competitors in exchange and acceptance business. These charges arose from after-war rescue work done by the Bank on the Continent; and it has now been laid down by a Deputy-Governor that "a central bank should not ordinarily compete with the trading banks for general banking business." [1]

In the days of the old grievance, however, Bank rate was so seldom effective that if the Bank wanted discount business, it had to take bills at a lower rate. If it had taken bills in the country only at its official rate its customers, the other banks, would have had no genuine cause of complaint, and the Bank would

[1] *Central Banks*, by Sir Ernest Harvey, K.B.E., page 20.

have got few bills, if any; but when it stepped off its pedestal and entered into the chaffering circle of the market, and chaffered against the market with the market's money, the market had reason to feel that it had a grievance.

This want of connexion between the official rate and the market rate also had the effect of leaving the market rate wholly without regulation. The market rate, in those antediluvian days was at most times practically arrived at by competition among the other banks and higgling between them, the bill-brokers and the sellers of the bills; and hence it was ruled by mere haphazard cross-currents of individual conceptions on the subject of any particular business proposition that might come forward, and was not directed by the guidance of any consideration for the welfare of the market and of the monetary world as a whole. An individual banker or bill-broker who wanted to add to his holding of bills or renew his maturities naturally discounted at the best rate he could get, and could not be expected to stop and wonder whether his purchase at a lower rate of discount would have an adverse effect on the foreign exchanges, or give some foreign financier too close a hold on London's store of gold. Hence it often happened that we read in the money articles of the newspapers remarks expressing regret concerning the rapidity with which rates were being allowed to decline, as if the bankers and bill-brokers were carrying out some questionable and immoral transaction, when all that they were doing was to buy the bills that they wanted at the only rate at which the conditions allowed them to do so: and it used to seem strange that City editors should shake their heads so sadly about the behaviour of the discount market,

while they accepted a rise or fall in Consols as due to the inevitable action and reaction of supply and demand in the stock market.

The justification for this attitude towards the movements of the discount market arose out of the very close connexion which we have already seen to exist in more normal times, between the market rate of discount and the foreign exchanges. When the market rate of discount was allowed to fall relatively low in London, bills of exchange were naturally sent here in increasing numbers from foreign countries to be discounted; that is to say, our imports of securities were stimulated, and so the balance of international indebtedness was affected, we had more payments to make abroad, and the rates of exchange tended to move towards the point at which it paid better to ship gold than to buy drafts. The London rate was normally low when compared with those of other centres; but the extent of its relative lowness was a question of degree; and when this degree became exaggerated in a manner which the general monetary outlook did not seem to justify, a situation arose which occasionally called for deprecating comment by the Press, which endeavours to reflect the judicious opinion of the City. The individual bankers and brokers, however, whose competition depresses discount rates, were little deterred by these considerations; in the first place, because each one would think it absurd to suppose that his individual action would have any appreciable effect; in the second, because even if it had, he would consider that he could not be expected to refuse a fine parcel of bills in order that by holding out for a higher rate he might prevent an adverse movement in the exchanges. Adverse exchanges made

them cautious in their purchases of bills in their own interests, because adverse exchanges generally held out a promise of higher rates, and so encouraged buyers to wait. But individual buyers could not be expected to be deterred by consideration for the interests of the market as a whole.

So once again we arrive at the fact that the store of gold which the Bank of England was expected to keep was constantly threatened by a mass of credit created by the other banks, which worked without any immediate reference to the Bank of England's position, but to suit the requirements of their own business. And thus the beautiful elasticity of our monetary system led to a certain lack of cohesion, which required, occasionally, drastic measures by the Bank of England to correct it.

This lack of cohesion was a comparatively modern development, and had arisen out of the great growth of the credit-making machinery which was outside of the Bank of England, but was loosely founded on its reserve, and rendered its reserve liable to attack by every credit given to a foreigner, by means of a discount or an advance. In Bagehot's time the power of the Bank of England was evidently much more easily exercised, and we find him stating, in the passage quoted on page 173, that in normal times Lombard Street could not discount its bills without the help of money provided by the Bank. In other words, when he wrote, Bank rate was always effective, save on exceptional occasions.

So far was this from being so in later days that to make its rate effective, the Bank of England often had to borrow money that it did not want, because, the market supply of money being abundant,

it knew that the bankers and brokers would continue to discount bills at rates which would keep the foreign exchanges against us, unless a curtailment of the supply of money was carried out. In other words, the credit-making machinery had worked so efficiently in the output of its product that the Bank of England which had to be ready to meet the liabilities so created, had to take some of the output away from its holders, and pay them a rate for restricting their temptations to take bills at too low rates.

This it did by going into the money market and borrowing. Any money that it borrowed could only be got back from it by being borrowed again, and it, of course, only lent, at its head office, at the official rate, or ½ per cent. above it.

It has already been observed that when the Bank of England lends money the result of the operation is generally expressed in a book entry, by which it shows more securities (which it has received as collateral) among its assets, and more deposits among its liabilities. When it borrows, the book entry of course works similarly, but contrariwise; its holding of securities is reduced by the fact that part of them is pledged to the lenders, and the amount that it borrows cancels so much of its liability under deposits, in other words, reduces the balances of the other banks, and so narrows the basis of credit, makes money dear, brings the market rate of discount into some connexion with the official rate, influences the foreign exchanges, and, under gold-standard conditions, increased the probability that gold would be sent to London, or that gold which arrived would not be taken for export. By this roundabout process the Bank finally arrived at its object of protecting or increasing its reserve.

It has been said that by borrowing money the Bank of England reduces the balances of the other banks; this it did either directly by borrowing part of their balances from them, or indirectly, by borrowing from the Consols market, or from the bill-brokers and finance houses, who paid it what they lent with cheques on the banks, which to that extent cancelled the balance of the banks in question at the Bank of England. The banks in question, having their balances at the Bank thus reduced, either reduced the credits that they had based on them, or more probably restored their balances by calling in money from the bill-brokers, their loans to whom have already been described as their second line of defence, after their holding of cash in hand and at the Bank of England. The bill-brokers, from whom these loans were called in, first had recourse to the other bankers and money-lenders, trying to fill the gap that has been made in the funds on which they work their business, but were finally, as it generally happened, driven to the Bank of England, whence they had to borrow part of the money that it had borrowed from the market, and would have to pay for it at or over the official rate, which was thus made effective, and became a controlling factor in market rates. This system, of borrowing in order to reduce the market's surplus cash, has now been developed into the "open market operations," by which central banks can produce ease or stringency by increasing or reducing their holding of securities.

The bill-brokers, whom we have seen to be the first sufferers when the Bank of England thought it necessary to reduce the overgrown mass of credit, generally waxed eloquent concerning the absurdities of the

system, the hardship involved to all legitimate users of credit when it was thus artificially controlled, and the monstrous interference with the natural laws of supply and demand, which ought, they contend, to be left to regulate the value of money like that of every other commodity.

Their position was certainly one with which a disinterested observer could readily sympathize, for they were constantly tempted, not to say forced, by the free credit facilities given by the other banks, into taking bills at rates which had an adverse effect on the foreign exchanges; and then the Bank of England, in order to rectify the position, had to reduce the mass of credit, and the bill-brokers found themselves, with their portfolios full of bills taken at low rates, artificially deprived of the wherewithal to carry them, and obliged to pay an unexpectedly high price for money to finance their bills, or rediscount them with the Bank of England at a loss.

Nevertheless their appeal to economic first principles, and the natural laws of supply and demand, does not seem to bear examination. Even in the production of agricultural and industrial commodities the law of supply and demand, if left unfettered, brings many evils in its train, the most obvious among which are the periodical spells of exuberance and depression to which the producing industries are habitually exposed, to their own loss and that of the community as a whole. For some time past the civilized world has submitted to these evils as inevitable or as small in comparison with the great benefit arising from the increase in production that has taken place under the system of unrestricted competition; but this acquiescent attitude has lately been drastically modified. The modern

trend of production is certainly in the direction of co-ordination, combination, and regulation, and unrestricted competition is fighting for its life against official and other assailants.

But in this matter of the supply of credit and of credit instruments it has long been recognized that regulation is essential, and that the free play of supply and demand cannot be left to itself because of the vast and wide-spreading disasters that result to the whole of a community from any dislocation in the machinery of credit. Moreover, it must be remembered that supply and demand cannot possibly work as effectively in the case of money as in that of an ordinary commodity, because of an important and essential difference which sets a great gulf between money, in the modern English sense, and concrete and tangible commodities. This difference lies in the fact that the cost of production of money is a negligible factor in its price. If the farmer is bid £1,000 for his crop, his answer will be strongly influenced by the amount of work and capital that have been spent on producing it, and will be required for producing another; when a banker is bid 4 per cent. for a loan of £1,000 for six months, in other words, is offered £1,020 six months hence for £1,000 to-day, the sum that it will have cost him or somebody else to produce that £1,000 will hardly enter into his calculation; for it will be merely a matter of cheque drawing and book entries involving a certain amount of penmanship, and whether the loan is for £1,000 or £1,000,000 will make little difference—very likely none at all—to the cost involved to the producer of it. It was quite otherwise when money consisted of metal that had to be dug out and treated; but now that money is a matter of book entries and

pieces of paper, which are brought into being according to the varying views of bankers, as to how much may safely be based on a given quantity of legal tender cash, the supply of money can obviously be multiplied without any question of cost, so long as borrowers have security to offer, and bankers are prepared to make book entries.

Regulation is in fact already an accepted part of our monetary system, and we have seen that the Bank Charter Act carefully and precisely regulated the number of bank-notes that might be created. If the bank-note had retained its position as the most important of our credit instruments, Bank rate would have retained its control of the money market, that is to say, the rate at which the Bank of England was prepared to provide borrowers with notes would have remained the dominant factor in the price of money. But we have seen that the regulation arranged by the Bank Act has been set aside by the development of the use of cheques, and the dominant factor in the price of money is now the rate at which the other banks are prepared to provide borrowers with the right to draw cheques.

This price, however, at which the other banks were prepared to lend to the bill-brokers was, between the two wars, more closely controlled by the Bank of England as already recorded.[1] At one time it then ruled at ½ per cent. against Treasury bills and ¾ and 1 per cent. against other collateral. The bill-brokers were able to get money cheaper from other lenders, but the bulk of what they call their "good" money—that is of money that they can generally count on as likely to stay with them in normal circumstances—had its price thus regulated by Bank rate.

[1] See *ante*, page 99.

But the Bank of England's control of the market rate has been reinforced by several other important changes in the position of itself and the other banks.

In the first place, owing to the process of amalgamation and consolidation that has reduced the number of banks in England and Wales from sixty in 1908 to nineteen in 1936, there has been a great elimination of small comparatively weaker brethren, whose naughtiness in the matter of inadequate cash reserves and over-creation of credit was a cause of anxiety to the leaders of the banking world at the earlier date. Hence the unwieldy supply of surplus credit which used so often to reduce Bank rate to a mere empty symbol has been largely absorbed by the growing needs of the country's business, and during many years, unless either the market or the Government was "in the Bank" as a borrower, it was safe to expect stringency.

Since 1932, however, the official policy of cheap money has expressed itself in a widening of the basis of credit, by increases of the note issue, backed by increases in the Bank's stock of gold, and increases in the deposits of the other banks at the Bank (which they regard as cash) due to increases in the Bank's advances and investments. Stringency was thus an almost forgotten experience in the money market; and when there was any danger of its being acute, as happened at the end of the half-years and especially at Christmas-time and at the turn of the year, official measures to relieve it were usually employed. Moreover the market, by holding Treasury bills due at seasons of possible stringency, could oblige the Treasury to provide it with funds, and to borrow from the Bank for this purpose.

The Government also borrowed from the Bank in order to meet interest payments for which the ingathering of taxes had not provided the necessary funds. This was especially likely when the half-yearly dividends on the £2,000 odd million War Loan fell due in June and December. In the weekly figures of national revenue and expenditure for the week ended June 5, 1937, ordinary revenue only amounted to £8 millions (as we all know, it is during the March quarter that the tax-gatherer is most effectively busy) and total ordinary expenditure, including £30½ millions for interest and management of debt, absorbed £43¼ millions. On this occasion part of this gap between income and outlay was filled by receipts on account of the recently issued National Defence bonds, but the Chancellor had had to borrow £9½ millions in the form of advances from the Bank of England, and to reduce his balance at the Bank by £14 millions.

As to Treasury bills, before the war the outstanding amount of these short-dated official promises to pay was modest. Taking a date at random, there were £20 millions of them on January 17, 1914, of which 11½ had been issued by public tender. On May 8, 1936, the figure was £683½ millions, and every week the market was invited to tender for anything from £30 to £45 millions of them.

Evidently the management of this immense mass of floating debt gives great opportunities for manipulation of the market by the Bank in conjunction with the Treasury and the Exchange Equalization Fund. By reducing the amount of Treasury bills offered in any week, and finding money by drawing the Government balances low, or by borrowing from some Government department that happens to be in

funds, it is possible to make money easier, and *vice versa*.

Moreover the Bank itself naturally holds large amounts of these and other forms of short-dated Government debt and by increasing and decreasing these holdings can influence the market in the direction of ease or stringency. As an example of its working for stringency—more usual in strict gold-standard days—we can cite the *Economist* of May 18, 1929, saying that "a feature of this week's strong Bank[1] return is a fall of £2 millions in bankers' deposits, reflecting, probably, further sales by the Bank of Treasury Bonds. It is believed, also, that the decline of £2 millions on discounts and advances resulted from the Bank's becoming a considerable seller of bills, with a view, presumably, to bringing market discount rates into closer correspondence with Bank rate." This was an occasion when the market rate had slipped down to little better than 5 per cent. at a time when the New York Stock Exchange was bidding 15 per cent. for call money and the New York exchange was very near gold point. Bank rate was 5½ per cent., having been raised from 4½ per cent. early in February in order to protect the Bank's stock of gold against the drain threatened by the high rates current in America.

In those times it more often happened that in order that the Chancellor might sell his Treasury bills at reasonable rates, or for some other reason, the Bank wanted to let the market off the expense of borrowing from it, or discounting bills with it at the official rate. It did so by buying bills from bill-brokers at or about the market rate, through an intermediary. When this

[1] The Bank Return will be explained in the next chapter.

happened the market talked of having been relieved by "the hidden hand."

Another important change that had eased the task of the Bank in regulating the market, was the closer touch that it kept with the other banks and with the bill-brokers. The Committee of London Clearing Bankers met periodically at the Bank of England, and its meeting was attended by a representative of the Bank and the proceedings included lunch. A representative of the discount houses paid a weekly visit to the Governor, or his Deputy, and conveyed to his colleagues in the market any comments on the position that might have been put before him. The Bank also took a much closer interest in the activities and position of the bill-broking companies and firms, requiring periodical balance-sheets from them and sometimes expressing paternal solicitude concerning the conduct of their business to an extent that roused humorous references to the "orderly room."

In these and other ways the Bank could convey its views and wishes more directly than of yore. Its policy and methods were often criticized and grumbled at, but, on the whole, generally respected and followed, with a docility that sometimes surprised old-fashioned observers. An interesting example happened at the time when, in order to facilitate our return to the gold standard, the Bank intimated that foreign loans (which, it will be remembered, turn the exchanges against us [1]) were inopportune. This ukase had no force in law, and was questioned by some critics, who said that it sent good business from London to New York, and that New York, having pocketed the

[1] See page 157.

issuing commission, sold the bonds to London and so put the exchange against us after all. But it was obeyed; and this control, later revived and exercised by a "Foreign Transactions Advisory Committee," has now been widened into a Capital Issues Committee.

In fact, so much was the market controlled by manipulation and what it calls "wangling," that changes in Bank rate seem likely to be much less used than of yore as a means of regulating credit. Since we were forced off the gold standard, and the Exchange Equalization Fund had been established, and the Government had openly adopted cheap money as part of its policy of trade improvement, the hold of the Bank, working in close connexion with the Treasury, over all the activities of the City has grown even tighter. The power of the authorities to widen the basis of credit, by buying securities and increasing the fiduciary note-issue is, in theory, unlimited, though in fact it can only be exercised with a careful eye on the effect of such action on confidence, domestic and foreign, in the stability of the pound. Since 1932 Bank rate has been unchanged at 2 per cent. and the market rate has hardly moved more than a fraction from ½ per cent. Foreign loans have been practically prohibited, domestic issues have been rationed and a semi-official committee has tried to regulate even the investment of their funds by insurance and Trust companies.

On the other side of the account, critics have to admit that the Bank's influence has been stimulating as well as restrictive. By its practical support of the United Dominions Trust, which provides credit for enterprise, and through the operations of the Bankers'

Industrial Development Company, it worked hard during the depression to promote industrial revival; and it continued this policy through a scheme designed to bring the Jarrow district back to active life.

CHAPTER XIII

THE BANK RETURN

IN days when the money market was chiefly employed in financing industry and trade, and only occasionally the requirements of Government, the account issued every Thursday by the Bank of England, giving a statement of its position on the previous day, was generally regarded as the key to the condition of the market as a whole and was awaited and examined with keen interest. Much ingenuity was often required in unravelling the meaning of the movements in the various items, for the return was by no means a model of lucidity, though greatly improved in this respect by some changes made in November, 1928, at the time when the Treasury notes, issued in 1914, were taken over by the Bank and fused with its own notes. Some attempt at comprehension of the return is so essential to those who wish to grope their way through the mysteries of the money market, that we must try to arrive at some sort of distant acquaintance with it. Further than that we need not expect to go. It may be said of all balance-sheets that they are useful as a general indication, but apt to be misleading if used as a basis of detailed inferences, except by those who can go behind the figures and find out what they really mean. In the case of the Bank return, which may be said to be a balance-sheet of a kind, only the broadest and most guarded deductions are possible, and they should be accepted with caution. Parlia-

mentary wisdom, expressed in the Bank Act, decreed that the note-issuing business of the Bank should be separated from its banking business, and that this separation should be shown in its weekly account, which gives two separate statements, one showing the position of the Issue Department, the other that of the Banking Department. It has frequently been suggested that this distinction is unreal and only darkens counsel, and that the Bank return would be clearer and simpler if the two statements were put together. There is something to be said for this view, but perhaps hardly enough to justify an alteration which would change the face of the return so completely and confuse comparisons with its predecessors of the past eighty odd years. Overleaf are specimens of the account as presented in 1936 and 1908; their figures are influenced by their being the last return of a half-year, so that the Other Deposits and Other Securities are increased by the Bank's provision of emergency credit. But they will serve as illustrations.

In the presentation of the Issue Department's figures, the changes made have saved the inquirer some trouble, but, except in one important item, have not told him anything that he could not find out by doing a sum or two. On the left side, in the old account, was the one figure of the notes issued and outstanding, from which, in order to arrive at the circulation, one used to have to subtract the notes held among the assets of the Banking Department. The modern return works this out for us, showing notes in circulation and notes in the Banking Department. It should be remembered, however, that the notes in circulation are not only those which we carry in our pockets and pay across shop-counters, but also those which are

BANK OF ENGLAND.

AN ACCOUNT pursuant to the Act 7 and 8 VICT. cap. 32, for the week ending on Wednesday, the 1st day of July, 1908.

Issue Department.

	£		£
Notes Issued .	55,484,385	Government Debt .	11,015,100
		Other Securities .	7,434,900
		Gold Coin & Bullion	37,034,385
		Silver Bullion . .	
	£55,484,385		£55,484,385

Dated the 2nd day of July, 1908.

Banking Department.

	£		£
Proprietors' Capital	14,553,000	Government Securities	15,231,766
Rest	3,214,365	Other Securities .	36,347,819
Public Deposits—		Notes	25,508,120
(including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts) . . .	9,648,021	Gold and Silver Coin	1,573,008
Other Deposits. .	51,197,083		
Seven-Day and other Bills . .	48,244		
	£78,660,713		£78,660,713

Dated the 2nd day of July, 1908.

BANK OF ENGLAND.

AN ACCOUNT for the Week ended on Wednesday, the 1st day of July, 1936.[1]

ISSUE DEPARTMENT.

	£		£
Notes Issued—		Government Debt . . .	11,015,100
In Circulation	439,641,851	Other Government Securities	248,127,219
In Banking Department.	41,469,734	Other Securities	96,052
		Silver Coin	761,629
		Amount of Fiduciary Issue	260,000,000
		Gold Coin and Bullion .	221,111,585
	£481,111,585		£481,111,585

BANKING DEPARTMENT.

	£		£
Proprietors' Capital . .	14,553,000	Government Securities . .	110,403,310
Rest	3,441,272	Other Securities—	
Public Deposits* . . .	9,909,953	Discounts and advances . £10,625,707	
Other Deposits—		Securities . 15,920,145	
Bankers . £111,707,232			26,545,852
Other Accounts . 39,765,961		Notes	41,469,734
	151,473,193	Gold and Silver Coin . .	958,522
	£179,377,418		£179,377,418

* Including Exchequer, Savings Banks, Commissioners of National Debt and Dividend Accounts.

Dated the 2nd day of July, 1936.

held by the other banks to meet daily demands on them for cash.

There is also this important difference between the Bank of England notes of 1908, or of any date up to November 21, 1928, and those of to-day. The old notes were of not less than £5 denomination, and so

[1] Figures were taken for 1936, so as to avoid the complication caused by the recent reduction, said to be temporary, in the fiduciary issue to £200 millions (see p. 205).

were rarely used for ordinary pocket-money transactions, except on race-courses and other places where one was apt to have dealings with folk whose cheques one would not be eager to take in payment for a debt For large commercial transactions, cheques were the almost universal form of payment; and Bank of England notes were seldom used to complete a bargain except when houses and land were changing hands. They were thus, in pre-1928 times, chiefly used as part of the cash reserve of the other banks, which could—and on rare occasions did [1]—use them to meet demands on them from customers for cash, when they had not, or feared that they might not have, enough sovereigns to give the customer the choice. Usually, however, "How will you take it?" was the invariable cashier's question when a customer wanted cash, and most of us generally took sovereigns up to 1914, and when they had been swallowed up by the war, £1 or 10s. Treasury notes. Why these war-time excrescences on our monetary system were ever permitted, and why, when our sovereigns had to go to the front, the Bank of England was not at once empowered to issue £1 and 10s. notes, perhaps we shall some day be told, if anybody is still interested in the question. Sufficient for to-day is the fact that the Treasury notes which took the place of our gold currency, have now been replaced by Bank of England notes, which are thus practically the only form of legal tender money—that is money which creditors are bound to take in payment—for all transactions of more than £2, up to which silver, or its cupro-nickel substitutes, may be used. The notes of to-day are thus much more really in circulation than their £5 fore-

[1] See *War and Lombard Street*, by H. Withers, page 13 *seq.*

bears. Formerly, when the public wanted more cash, sovereigns were taken from the Bank; or, between 1914 and 1928, Treasury notes were issued by the Currency notes department. Now, the demand falls on the Bank of England notes held by the Bank of England's banking department, with the result what is called its reserve is subjected to big fluctuations when cash is wanted for holiday or other purposes.

It is worth while to note that this periodical pressure on the Bank's reserve, owing to demands for home circulation of cash, is not, as is sometimes implied by writers who have grown up since the war, a new and rather serious liability that the Bank has to face. It is only a reversal to pre-war conditions. Then, sovereigns went into circulation. They went out of the stock of coin and bullion held in the Issue Department and the notes issued against them had to be cancelled. Notes in circulation obviously could not be cancelled; so notes held in the Bank's banking department had to be reduced and the Bank's reserve was diminished.

On the assets side of the Issue Department's statement, we find some important changes. These assets are the items on which the notes are secured. First comes the Government debt, swollen to over 11 millions from the £1,200,000 to lend which to Dutch William's Government the Bank was originally founded; this is not represented by any holding of stock, but is a book-entry between the Government and the Bank. Originally, it was the largest item in the securities which the Bank was allowed by the Bank Act of 1844 to use as backing for its notes, to the extent of £14 millions. Above this limit, every note had to

have metal behind it. The notes which had not metal but promises to pay behind them, were called the fiduciary, or confidential, issue; it was limited to £14 millions, but the Bank was allowed to take over two-thirds of the authorized powers of issue of any bank which thereafter might let its note issue lapse. By means of these lapses, which happened chiefly when country banks were absorbed by companies which had London offices and therefore were barred from note issuing by the Bank of England's monopoly, the fiduciary issue had grown to £18,450,000 in 1908, and to £19,750,000 in 1928, when it took over the Treasury notes.

To enable it to do so, the Currency and Bank Notes Act of 1928 was passed, by which the fiduciary issue was raised to £260 millions, and it was also provided that silver coin to an amount not exceeding £5½ millions might be included in the securities to be held against it. As to the rest of the securities, the only thing specified about them in the Act was that they should be "of an amount in value sufficient to cover the fiduciary issue for the time being" and that the Bank should from time to time "give to the Treasury such information as the Treasury may require with respect" to them.

This absence of any restriction on the kind of securities by which the fiduciary issue might be backed, was believed to have been a momentous change in the law, by people who were under a mistaken impression that the old Bank Act only allowed the Bank to hold British Government securities in the Issue Department and thereby (so they contended) limited the elasticity of the note issue. In fact the Act of 1844 only instructed the Bank to transfer the Govern-

ment debt of £11 millions to the Issue Department and " other securities " to an amount sufficient to back the fiduciary notes. It could, if it had wished to do so, always have based part of the fiduciary issue on bills of exchange, which some reformers wanted it to do; but in fact it was always believed that all the securities in the Issue Department were obligations of the British Government.

As long as the whole of the Bank's fiduciary issue was less than £20 millions, this question was comparatively unimportant. Now it is another matter, and the Bank has recognized it as such by not only putting some non-Governmental promises to pay behind its notes, but also by publishing the fact as part of the increased information which it has, without any legal obligation, given in the new form of its return.

Reference has already been made (on p. 22) to the powers granted by an Act of 1928 to the Bank to raise or reduce the amount of the fiduciary issue with the consent of the Treasury. The right to raise it was exercised in August, 1931, when it was raised—at the beginning of the crisis which led to the fall of the pound from gold—to £275 millions, at which point it remained until March, 1933, when it returned to the statutory £260 millions. A reduction happened in December, 1936, when the Exchange Equalization account had become, as the *Economist* hazarded in explaining the transaction, " uncomfortably full of gold," and the Bank suddenly announced a purchase of £65 millions of gold, obviously bought from it, and the Chancellor of the Exchequer told the House of Commons that he had directed the reduction of the fiduciary note issue by £60 millions, in order to prevent a sharp and unjustifiable expansion of the credit

base. By this device, the credit-base expansion was brought down to a modest £5 millions—this being the excess of the gold acquired by the Bank over the reduction in the fiduciary issue—and this expansion was, at the time, more than absorbed by the Christmas-time growth in the note circulation. The gold was presumably paid for in Treasury bills taken out of the Issue Department's holding. The Chancellor described the operation as a temporary measure; and it was accepted by the City as a rather startling example of the manipulative power now in the hands of the authorities.

Silver, by making its reappearance in the assets of the Issue Department, is an interesting example of the whirligig of time bringing in its revenges. Under the terms of the Act of 1844, the Bank was allowed to include silver bullion in the metallic backing behind its notes, the silver not to exceed one-fifth of the total metal; and silver was actually so held from September, 1844, when the first return was published under the Act, until August, 1853, and again between November, 1860, and July, 1861. Since that date no silver had been held in the Issue Department, and the Bank's power to hold it there had been almost forgotten—though a line, silver bullion, with a blank opposite to it, appeared in each week's return; but the existence of this power was brought home to the City in 1897, when the Chancellor of the Exchequer and the Governor of the Bank seriously discussed a proposal for its exercise. The arrangement was evidently due to pressure brought to bear on the Government of the day by the Bimetallists, who believed that gold and silver could be made to circulate on equal terms at a fixed ratio, to the benefit of all

concerned, and this mooted concession on the part of the Bank of England was part of a scheme for improving the position of silver. But it was nipped in the bud very early in its history. *The Times* found out what was afoot and exposed the scheme with dramatic effect. There was a great outcry in the City, where it was feared that the inclusion of silver in the metallic backing of the Bank of England note might impair public confidence in its convertibility into gold. This convertibility was regarded as the rock on which our gold standard was founded and any suggestion of a change that might run the risk of weakening it, even in appearance, was a shock to the practical sense of the City. No more was heard of the project, and gold remained and remains the sole basis of every note that is issued by the Bank above the limit fixed by law for its fiduciary issue.

Silver, however, had slunk into the Issue Department through the back door opened for it by the Currency Act of 1928, which allowed it to be included among the securities behind the fiduciary issue, but not as part of the metallic backing of the notes.

All these items—Government Debt, Other Government Securities, Other Securities and Silver Coin—the return now adds up for us to show that they are equivalent to the sum of the fiduciary issue, £260 millions, and the gold coin and bullion complete the assets by which the notes are technically secured, though in the eyes of the general public at home and abroad, the real security lies in the fact that the note has been issued by the Bank of England.

It is in the figures of the Banking Department that the new form of the weekly Bank return gives the most important new information, through the sub-

division of the Other Deposits and Other Securities. The first item that we see on the liabilities side is the proprietors' capital, which speaks for itself, being obviously the amount subscribed by the original stockholders of the Bank, with subsequent additions. It differed from the capital of the other English banks by being in stock instead of shares, and by being fully paid up, whereas it is now the fashion for banks to have a reserve in the shape of a liability on their shareholders for uncalled capital. But though the stock of the Bank of England was fully paid, authorities differed as to whether there was further liability on it. It was not a practical question, however, or one that kept proprietors of Bank stock awake at night, and has now ceased to be a question at all since the proprietors have been bought out by the Government.

The next item is the Rest, under which quaint name the Bank holds what most other banks and companies, which are fortunate enough to possess one, call a reserve. That is, it is an accumulation of profits which have not been distributed as dividends but kept in hand to strengthen the Bank's position. It may seem at first sight puzzling that the possession of a liability should strengthen a company's position, but this liability, like the subscribed capital, was a liability only between the Bank and its shareholders, and was, of course, represented by assets on the other side of the account, so that the proportion of assets to real outside liabilities—the demands that the Bank's customers can make on it—is strengthened by its existence. Unlike the reserve of an ordinary bank or company, however, the Bank of England's Rest constantly fluctuated, and it may be supposed that it more or less contained the Bank's profit and loss account balance.

But it was shifted about from week to week in a manner which an outside observer can note, but not understand, and apparently most of the profit and loss balance was included in the Other Deposits, which will be dealt with later, and was transferred to the Rest when it was wanted to pay dividends withal. At any rate, it was not unusual to see a large amount suddenly added to the Rest at the end of February and August when the Bank completed its half-year, and from the amount of the Rest at those dates it was possible to calculate what the distribution would be when the Bank Court assembled for the "making of a dividend." For the Rest was never allowed to fall below £3 millions, and the amount above that level at the end of the half-year was roughly the sum available for distribution. It may be noted that this three-million level of the Rest had been constant since 1844, and had not been increased in accordance with the addition to the Bank's outside liabilities. In September, 1844, the Rest was £3,564,729 and the total Deposits were £12 millions odd.[1] At the end of May, 1937, the Rest was just under £3¼ millions, and the total Deposits were £153¾ millions.

The Public Deposits are the balances of the various departments of the British Government, which are held and administered by the Bank of England as its banker. They fluctuate according to the briskness or sluggishness of the revenue payments, and the rapidity or slowness with which the Government is making its various disbursements. A large sum is taken off them, when the dividends on War Loan and other Government stocks are paid, and this sum is

[1] See the first return published under the 1844 Act, reproduced by photograph in the Midland Bank's monthly *Review*, December, 1928.

transferred to the Other Deposits, or ultimately finds its way there. The payment of the Government dividends thus tends to make money abundant, for it means that a credit at the Bank of England has been taken from the Treasury and turned into "cash in hand and at the Bank of England" in the control of the other banks, who can use it as the basis for the manufacture of more credit. On the other hand in the March quarter of the year, when we are all paying our income-tax and house-duty, the Public Deposits swell, the Other Deposits dwindle, and money tends to become scarce, or "tight" in the City phrase, though the Treasury generally uses much of the funds so acquired by paying off maturing Treasury bills. It is important to remember that an increase in the Public Deposits means an increase of credits over which the Bank keeps command and control, but an increase in the Other Deposits means an increase in its liabilities to the general public and in the "cash at the Bank of England" which is used as a basis for credit-making by the other banks.

"Other Deposits" used to be the comprehensive title under which the Bank included all its liabilities on deposits to anyone but the British Government. By subdividing it into bankers' deposits and other accounts, the new form of return has thrown an important new light on the monetary position. Under the old way of presenting the accounts, movements in the Other Deposits could not be trusted to show us how much credit at the Bank of England the other banks held, because an increase or decrease might affect some of the Bank's other customers, such as the Indian or some foreign Government. Now we are told each week how much the banks have got at their

credit with the central bank, and we are thus a step, and a long step, nearer to knowing what are the total resources of the banks—the amount of their cash in hand we can only get from the monthly statements of the London clearing banks, which appear about the 12th of the month following that which they depict and from the half-yearly or yearly reports of the rest; what, on each Wednesday, they have in the books of the Bank of England we can see next day in the Bank return. The banks included in this item are the London clearing banks, and those domestic banks which do not bank with another bank but only with the Bank of England. It should be noted, however, that some of the balances included in this item are kept by the other banks, not in Threadneedle Street, but at the Bank of England's branches in the country.

The Other Accounts are, by the process of exhaustion, already explained. They include the balances of all the Bank's depositing customers, except the British Government and the banks, as defined above. And the last item shown in the 1908 return on the liabilities side, a few thousand pounds' worth of seven-day and other bills—"a trifle, some eightpenny matter," as Prince Hal says—represented an old-fashioned form of remittance used for certain revenue payments. Since December, 1934, when it had shrunk to £40, it has vanished altogether.

We now turn to the other side of the account to consider the assets which the Bank holds against these liabilities to its stockholders and customers. We have seen that the two first liabilities, capital and Rest, are owed by it only to its proprietors, and are therefore not a debt in the same sense as the others, and, when working out the proportion of cash to liabilities,

it was only the liability to customers, the Government and other depositors that was included in the calculation.

In its treatment of the liabilities side of its account we found that the Bank to this extent had always given fuller information than other banks, in that it separated the Public from the Other Deposits; but on the assets side its statement, even in its new and improved form, is still distinguished by obscurity. It makes no distinction between its investments and its other assets, and its subdivision of the Other Securities, though illuminating to anyone who understands it, might easily mislead an uninstructed inquirer.

Here, again, Government means only British Government, and the item Government Securities covers the Bank's holding of Consols and other British Government stocks, Treasury bills, Exchequer bonds, and other short obligations of the Government, and any loans that it may have to make to the Treasury in the shape of Ways and Means advances, when the exigencies of "supply" or of dividend payments compel the Government to draw on its banker. As these temporary borrowing operations by the Treasury are indicated more or less by the weekly returns of public income and expenditure, published in the *Gazette*, it is possible with their assistance to get a dim glimpse of the meaning of the movements in the Government securities in the Bank return; but these Government returns are slow in appearance, inadequate in information, and obscure in expression, and show the position three days later than the Bank return; so that anyone who attempts to find his way with their help towards a comprehension of the relations between the Government and the money market is entering a path full of pitfalls. It used to seem curious that the money

market, which so often has to come to the assistance of the Government by subscribing to Treasury bills or otherwise, submits patiently to handing over its money to a borrower whose operations are veiled in so much mystery, and at the same time are of such great importance; but in these days mystery and obscurity in official monetary measures appear to be accepted as inevitable.

Broadly, however, it may be stated that when the Government securities item rises, either the Bank has been increasing its holding of Government obligations, funded or unfunded, or else has been making some sort of an advance to the British Government; and when it declines, it goes without saying that one of the contrary operations has taken place, that the Bank has been selling Government stocks, or having an advance repaid by the Government; but there is yet another possibility, for the Bank may have been borrowing from the market and giving some of its Government stocks as security. When it borrows in order to curtail the supply of credit it is usual to see a decrease in the Government securities, and sometimes in the Other Securities likewise. But it is important to remember that when the Bank lends money to the market its holding of Government securities is not thereby affected; even when it lends on the security of Government stocks, this security is only collateral and the borrowers' promise to pay is what it relies on first, and it therefore includes advances to any borrower but the British Government under Other Securities, nowadays under the subheading, Discounts and Advances.

Other Securities are now divided into two heads, Discounts and Advances, and Securities. By this

change the Bank has again done a great deed for the cause of enlightenment. The separation of the bankers' from the rest of the Other Deposits helps us to see better what is the position of the market. The subdivision of the Other Securities helps us to see better how it has got there. At the same time it must be admitted that as it stands the new form of the return seems almost designed to mislead anyone who tries to read it without a key to the cryptogram. An intelligent inquirer, reading these items in the light of ordinary experience, would naturally infer that Discounts and Advances mean what they say—bills bought and loans made by the Bank—and that Securities represent its holdings of stocks and bonds other than obligations of the British Government.

But the real distinction is quite different. It was explained in the *Economist* of December 1, 1928—and I have good authority for saying that the *Economist's* explanation was, as was to be expected, correct—that "Other Securities have now been divided so as to show the extent of market indebtedness to the Bank, this being substantially what is meant by the new item, 'Discounts and Advances.' The important distinction is this: Where a bill is discounted at the Bank on the market's initiative, the Bank will rank it as a 'Discount.' When the Bank buys bills on its own initiative as part of its open market policy, it will rank as a 'security'—'Government' for Treasury bills and 'Other' for commercial bills."

This new classification was thus based not on different classes of assets, but on the way in which certain assets came into the possession of the Bank; and whatever a scientific accountant may say about this psychological method of book-keeping, it unquestion-

ably tells us much that never could be guessed, not only by the old method of one comprehensive item "Other Securities" but also by a conventional subdivision into loans, discounts and investments.

What we want to know is, what the market has been doing with the Bank in the way of discounting with it or borrowing from it, and what the Bank has been doing with the market in the way of contracting or expanding credit, by disposing of securities, reducing advances or *vice versa*. This the new distinction shows, at least to some extent. When the bill-brokers have to go to the Bank for accommodation, by borrowing from it or discounting bills with it, there will be an advance in Discounts and Advances. If the Bank prefers that the market should not be squeezed by having to discount with it at the official rate, and so buys bills from it at market rates through the "hidden hand," the advance will be shown in the Securities. A further caution, however, is necessary. When we speak of the market's initiative, we must not use the market in the usual narrow sense. "Market borrowing," when one sees the phrase in the City articles, means borrowing by the bill-brokers. If Discounts and Advances only covered this kind of borrowing, we should be led to infer that ever since the new return came into being the bill-brokers had been in the Bank, which is by no means true. By "market initiative," the Bank means any discounts and advances which it may arrange for any of its borrowing customers, apart from the British Government. When anybody comes to it for money, it is market initiative; when it goes into the market to lend or borrow, it is pulling the strings through its "open market policy," and regulating the supply of credit.

To outside inquirers it may seem that by throwing this new light on the position the Bank has only made darkness more visible, owing to the technical obscurities involved by these explanations. To those who deal in money, however, the change has been welcomed as a real increase of information. From the point of view of the general public, all that need be remembered is, that any increase in the Bank's holding of securities, whatever label may be attached to them, will *pro tanto* increase the supply of money, and any decrease will reduce it. For since every amount lent means a corresponding credit in the Bank's books, an increase in the securities causes a corresponding increase in the deposits, either Public or Other; and if the Public Deposits have been increased by an advance from the Bank it may be assumed that this has been done because the Government has payments to make, and that the increase will shortly be transferred to the Other Deposits, and so will be added to the "cash at the Bank of England" in the books of other banks, which is regarded as equivalent to notes or gold as part of the basis of credit. Or the increased credit may be employed in the withdrawal of actual currency from the Bank, which will so be added to the cash in hand of the commercial community.

And now we come to the last two items on the assets side of the account, which taken together constitute what is generally spoken of as the reserve of the Bank of England. It should be noted that this reserve is, in accordance with the confusing habit of economic phraseology, a reserve in quite a different sense from the reserve or reserve fund of another bank or company. Ordinarily a company's reserve means

an accumulation from profits which have not been distributed as dividend but kept in hand for use in case of need. The Bank of England, as we have seen, possesses a reserve of this kind, and calls it its Rest. But when we speak or write of the Bank's reserve we mean its holding of cash in the Banking Department.

It consists chiefly of notes with a small proportion of gold and other coin ; the coin may be called the Bank's small change till money that it has in hand to meet cheques drawn on it, and for other ordinary banking business. Nowadays, we may probably assume that practically all the gold that comes into the Bank's hands goes into the Issue Department, and notes are issued against it and put into the assets of the Banking Department. These notes, now that they have taken the place of the gold coin that we used to carry, are the form of currency on which all home demands are likely to fall. When we want more money for holiday purposes, Bank of England notes go into circulation.

Foreign demands, in times of Continental mistrust, sometimes affected the Bank of England's reserve, when they took the form of a craving for Bank of England notes for hoarding purposes. In 1936, during the flight from the franc that preceded its second after-war revaluation, it was a common occurrence for French people to arrive in London with packets of French currency, or drafts on French banks, sell them to the foreign exchange departments of the English banks, and take away the proceeds in Bank of England notes and put them into a safe deposit vault, so causing an expansion in our note circulation, and diminishing the cash holding of our banks. The banks, in the meantime, had the French currency, acquired from

the hoarders, to dispose of; but the only buyer at that time was the Equalization Fund, which in order to pay for it had to sell Treasury bills (which, as we have seen on p 161, formed its original stock-in-trade) and these Treasury bills ultimately found their way to the banks either as part of their bill holdings or as collateral for loans to the bill-brokers. The banks thus found themselves with less cash, owing to withdrawals of notes by the French hoarders, and with increased discounts and advances. This process tended towards stringency in our money market which did not suit the cheap money policy of the authorities. They, however, were able to meet the position by the use of the gold which the Equalization Fund had acquired from the Bank of France in exchange for the French currency. Some or all of this gold was sold to the issue department of the Bank of England, against Treasury bills, with which the Fund was able to replenish its stock-in-trade.

The Bank of England could then replenish its holding of securities against the fiduciary issue, diminished by its exchange of Treasury bills for gold, and at the same time replenish the other banks' holding of cash, by buying Treasury bills from the market; and so the net result of this hoarding process was an increase in the Bank of England's gold-backed note issue, no change in its fiduciary issue, and a decrease in the gold stock of the Bank of France.

Since the Bank of England note is no longer convertible into gold, direct demands for gold on foreign account no longer affect the Bank's reserve. Indirectly, however, foreign demands, if the resources of the Equalization Fund were exhausted, might fall upon the Bank; and so, as we shall see when we

examine the possibilities of the present position, the size of the total gold stock held by the Bank and the Equalization Fund, is a matter which still has to be watched by the authorities, if they wish to maintain the stability of the pound.

CHAPTER XIV

THE GOLD STANDARD

AS originally written, most of this chapter and of the rest of the book was devoted to a discussion of the alleged inadequacy of the Bank of England's stock of gold and of the cash reserves of the other banks, and of various suggestions made for repairing this fault. Since then the Money Market's problem had been changed by developments already noted, chief among which are—

(1) the establishment of a link between Bank rate and market rate, through the rule by which the clearing banks regulate the price at which they lend money to bill-brokers by Bank rate;

(2) the many changes in the position which have given the Bank of England a closer hold on the market;

(3) the process of consolidation and amalgamation which has absorbed into larger units a number of comparatively small banks;

(4) the abolition of the convertibility of the Bank of England note into gold;

(5) the establishment of the Exchange Equalization Funds; and

(6) the nationalization of the Bank of England, to be dealt with later.

That old complaint on the part of the big banks which kept substantial cash reserves, of over-trading in the production of credit by their weaker brethren

is thus now a thing of the past. The clearing banks now all publish monthly statements showing their average weekly balances during the previous month, and they represent about 90 per cent. of the country's banking resources. But " window-dressing " was still criticized (by bankers as strongly as by anybody), until it was finally abolished in 1947.

So far, indeed, have we moved from the opinion that the proportion of cash held by the banks was inadequate, that their most austere critics sometimes congratulated them when they increased the fabric of credit that they raised on the basis of their cash. In its Banking Supplement of May 11, 1929, the *Economist*, after displaying a table showing that the nine English clearing banks had increased their deposits (by expanding their advances and discounts) by £66·7 millions between March, 1928, and March, 1929, while their cash had only risen by £0·7 million, said that " the first lesson to be drawn from this table is that the clearing banks have merited a great tribute from the nation for increasing the supply of credit granted by them to their customers during a year when their own supplies of cash remained virtually unchanged." So the naughtiness of one generation becomes the virtue of the next, and the process which used to be suspected as over-trading in credit, when some of the small weak banks had almost negligible cash reserves (which they did not show), merited a great tribute from the nation when it is done by banks which have consolidated themselves into positions of commanding strength.

With the power of the Bank of England over the London money market thus strengthened, its task of protecting the country's gold reserve had been made

easier during the gold-standard period from 1925 to 1931. At the same time it had been made much more difficult and tangled by the rise of the United States to a position of immense importance in international finance, and by the enormous scale of international indebtedness left as a legacy of the war. It had also been complicated by the appearance of a host of critics, ranging from Mr. J. M. Keynes, an economist of outstanding ability and world-wide fame, to amateurs who believed that the way to make humanity happy was to provide it with heaps of money, forgetting that what we consume is not money but goods and services. Between these extremes were a host of business men, who thought that they could do more business if they had more credit and accused their bankers, or the system under which their bankers had to work, of stinting the supply of credit. Then there were the political critics, who maintained for example that "a considerable portion of the available supply of credit, as well as a similar proportion of the national savings which are permanently invested, is in the national sense wasted in the support of enterprises which are nationally useless and may even be noxious"; and went on to urge that the governing body of the Bank of England should be made responsible to the community and not merely to individuals, and for this purpose should include representatives of the Treasury, the Board of Trade, Industry, Labour, and the Co-operative Movement.[1]

These many voices produced among them a big volume of sound, so much so that *Punch* thought them worthy of expression in a cartoon, in its issue

[1] *Labour and the Nation*, Supplement on Banking and Currency Policy.

of December 12, 1928. In it John Bull, dressed as a traffic-regulating policeman, was depicted as beckoning to a portly Old Lady of Threadneedle Street about to cross the way, and saying, "Step a bit more lively, ma'am; you're holding up the traffic." The Old Lady holds a bag marked "Obsolete Policy," and behind the policeman, waiting for the Old Lady to give them a chance to move, are vehicles labelled "Industrial Development," "Trade Enterprise" and "More Employment."

In fact, while in 1908 the gold standard was recognized generally as the monetary system which had been proved the most practical and workable, both for England and for international trade, by the experience of a century, there were, even before we were forced off the gold standard in 1931, some doubters, with high theoretical authority behind them, who thought that it was an obsolete barbarism, and there were many more sceptics who, while believing that it was the only workable system, were highly critical about it and its effects and doubtful about the spirit in which it was worked. In other words, the gold standard, though re-established, was on its trial.

A verdict against the defendant was the result of this trial and the gold standard was taken away to be hanged, or as it may perhaps turn out, to pass a few years in a reformatory and then be allowed to return in a different form and fitted with up-to-date gadgets, to suit modern tastes. It was condemned by the fact that it could not be worked under modern conditions—it needed a more or less civilized and sensible world, composed of nations at peace with one another and prepared to exchange among themselves, with more or less freedom, goods and services and

credits and securities. In these conditions, the gold standard linked together the moneys of all nations, and provided traders, lenders and borrowers with the benefit of stable rates of exchange and of confidence in their maintenance. But it could not work, with the leading creditor country performing speculative fireworks and first pouring out money (in the form of loans) in a flood and then sucking it in again with a rush, and with economic nationalism raising trade barriers and political bitterness undermining such remains of business confidence as the war had left. This "brave new world" could not work the gold standard and so condemned it as unworkable.

Most of us now agree that in 1925 England returned to it too soon; and many good authorities thought at the time that we were wrong in attempting to restore the old parity between the pound and the dollar or, to put it in another way, to make the pound convertible into the same amount of gold as before the war. If we were too hasty, this was a mistake based on a well-meant desire to get back quickly to normal conditions in money matters, so that normal intercourse might be resumed, in trade and finance, between the nations; and the fact that the great majority of the leading civilized countries followed our lead in going back to gold was a hopeful sign, indicating that this policy might be successful. In fact, our well-meant effort was defeated, partly owing to the external causes mentioned on p. 79—the collapse of the American gamble, followed by the run on Germany followed by a run on London—and partly owing to the rigidity of our industrial system, which made it impossible for us to reduce sterling prices and our cost of production, combined with the too great readiness of our financial

houses, again in the well-meant desire to get international trade going, to grant credits abroad, especially in Germany. For the rigidity of our industrial structure some blame the labour leaders, some the employers. An impartial observer will find it difficult to blame either of these parties. The workers had excellent reasons for refusing, if they could possibly help it, to consent to reductions in wages. Why, they could most reasonably ask, should the standard of life for which they had fought so well be attacked first, when a host of critics, including some of the industrial leaders, were telling us that British industry was ill-organized and out of date and that its selling machinery was even less effective than its productive outfit? It was, surely, the business of the employers to set their house in order before they asked wage-earners to make sacrifices. To which the employers might well retort that they could not be expected to reconstruct, with all the world putting up tariffs against them and pouring dumped goods into their home market, while at the same time they were hampered by a crushing burden of taxation. With such strong arguments on both sides, deadlock resulted, and the deflation, or reduction in costs, necessitated by the raising of the exchange value of the pound, could not be secured.

In favour of going back to the old parity, instead of returning to gold with a lower gold content for the pound, and consequently a lower exchange value for it in dollars and other currencies, one argument, that was strong in the minds of many of us, was based on considerations of common honesty. Foreigners had, during and after the war, left money in London in the expectation that when they wanted it back, it would be paid out in as good money as was paid

in. Debasement of the pound, except under the pressure of extreme necessity, would have been an act of partial repudiation of debt; and debt repudiation was not, in those days, as fashionable and general as it has become since then.

Besides this honesty argument, which now sounds so Victorian and obsolete, voluntary debasement would have been a bad blow to the prestige of the pound, of which we had once been so proud; and in favour of returning to the old parity was the hope that the Federal Reserve banks would make money cheap in America and so push gold prices up to meet sterling prices, which were to be reduced. In fact, however, owing to the causes already mentioned the reduction in sterling prices was too slow, and the American cheap money only assisted the development of the Wall Street gamble, with its devastating consequences. And so this first and very well-meant attempt at international monetary management came to a disastrous end.

Then, in 1931, came that pressure of extreme necessity which not only justified but compelled our abandonment of the gold standard and the consequent depreciation of the pound. The "standstill agreement" bound Germany's creditors not to call on German debtors to pay, and so the run on Germany became a run on London, which was known to have given large credits which were thus frozen; and the report of the May Committee on National Expenditure, increased the mistrust of our creditors by accusing the Labour Government then in power of having outrun the constable to the tune of £120 millions. (Of this alleged "deficit," however, £50 millions was an amount which, in the Committee's opinion, ought

to have been applied to debt redemption.) So, even though the Labour Government was replaced by a National Government, pledged to economy and sound finance, and New York and Paris lent in all £130 millions to London, the run went on faster than ever, especially when a few sailors refused duty owing to cuts in their pay, and a "naval mutiny" was hailed abroad as the beginning of revolution here as it had been in Kiel and at Petrograd. This was the last straw on the back of the golden camel—as a wholehearted opponent of the gold standard said, "the Navy had once more saved England." No more could be borrowed abroad, and the shutters went up. In the words of M. Charles Rist, the distinguished French monetary expert, printed in the *Economist* of October 3, 1931, "the pound has fallen, like a good soldier, fighting for the stability of the currencies of Central Europe. The pound fell as a result of unjustifiable panic; the forces which led to its fall were largely external to England itself. In my opinion the financial crisis would never have become so acute as it did had it not been for the recrudescence in Europe of a policy of nationalism which superimposed on an already serious economic crisis a universal sense of political uncertainty." Once more we come back to the war and its after-effects as the cause of all the disasters that have prevented the world from enjoying the prosperity and comfort that increased productive power makes available.

But this disaster, which our National Government had striven so stoutly to avert, proved to be a blessing and the turning point from depression to recovery. England had once more brought off a brilliant fluke—thanks to the lower exchange value of the pound,

which rapidly depreciated, Britain became a better country to buy from and a less profitable customer to sellers; and further heartened by a protective tariff, the necessity for which under the circumstances was acknowledged by all but the most stiff-necked free-traders, British industry began to pick up its courage and tuck up its sleeves. Our example was at once followed by a large number of countries and at last even by the United States, which, with a huge gold stock and a large favourable balance of trade, had not the smallest excuse for this deliberate depreciation of its currency, but apparently believed that we had done something clever and so did likewise.

And so there came about a momentous change in the sentiment of nations with regard to their currencies. Debasement of the currency, which used to be regarded as an act of dishonesty only indulged in by needy medieval monarchs or revolutionary Governments, is now called by the politer name of devaluation, and is looked on as a handy weapon for effecting economic adjustments, only dangerous because it can be so easily defeated by similar action elsewhere. By devaluing your currency you can, it is now discovered, stimulate employment and improve your balance of trade—only, your next-door neighbour can lay you a stymie by devaluing his rather more.

With this new sun shining in the monetary sky, all kinds of possibilities are open to us and to other nations of currency manipulation and wangling, within the limits imposed by the fear of a general race in depreciation. Before we try to see what sort of shape these devices will take, we have to make up our minds about what we want from a banking system and what are the objects for which we can ask our Bank of

England and the central banks of other countries to work. In other words, what are the qualities which we want the money, the supply of which they regulate, to possess?

Our answer to these questions will depend, to a certain extent, on the kind of work that we do and our position in the economic world. To the great majority of us, wage-earners, salary-earners, and professional and other workers whose fees and payments are more or less fixed by custom, what we want to be sure about is that the money that we earn can be trusted, when we spend it, to buy for us as much as it did last week or last year or as long as we can remember; and that any money that we lend or invest will buy as much when it is repaid in a year, or in fifty years, as when we lent or invested it. That is, we want our money to be stable in value, and in purchasing power over the goods and services that we need for our existence and comfort. If it is not, if we find that everything, or most of the things, that we want cost more, so that our money does not go so far, we begin to suspect either that somebody is making too much out of us, or that there is something wrong with the money in which we are paid; and we grow discontented and think that we ought to have higher wages or salaries, or that the fees that we are paid for pulling out teeth if we are dentists, or for writing articles if we are scribes, ought to be raised. From the wage-earner with three pounds a week to the leading barrister with forty thousand a year, this quality of steadiness in buying power is what we want most from our money.

Some of us may go further and think that it would be pleasant if the money that we earn should rise

in value and buy us an increasing amount of the things that we want—that is, we should like to see a steady fall in the prices of goods and services. This would certainly pay us best, as long as we continued to be paid the same wages or salaries or to receive the same fees for our professional jobs, and if at the same time we were able to sell our work with the same ease and readiness. Under these conditions falling prices are a boon to us. But we cannot count on these conditions continuing. As will be shown when we consider what is wanted from money by employers, merchants and business organizers, falling prices are generally believed to be bad for business. They certainly tend to reduce the profits of industry, and when they are prevalent, we are in danger of having our wages or salaries reduced if we are wage or salary earners; while professional workers are likely to find that those of their customers whose incomes depend on the profits of industry will go to cheaper doctors and dentists, send their children to cheaper schools, think twice about expensive lawsuits with K.C.'s at fancy prices, and reduce the advertising in newspapers which helps the scribe to sell his "copy."

Steadiness in buying power, with a slight bias in favour of its increase, is thus what most of us want from our money, which means that we want the general level of prices to be steady, or to fall slightly as long as it does not produce business depression, which will ultimately affect us, by falling.

From the point of view of the employers and organizers and all who, as shareholders, live on the profits of industry, the wind is on the other cheek. To them steadiness in the buying power of money is desirable, but with a bias in favour of a decrease in its buying

power, that is of rising prices for the commodities and services that they produce or handle. They, or nearly all of them, whether makers or dealers, manufacturers or merchants, are obliged by the nature of their business to hold a stock of goods and to be chronic borrowers of money.

The bootmaker has to have his stock of leather and also his stock of half-finished and finished boots, the silk merchant has his stock in his warehouse waiting to be sold. If prices of these articles are falling, both maker and merchant will get less money when they sell their goods, their stock-in-trade when they make up their balance-sheets at the end of the year will have to be written down to current prices, and unless they have succeeded in cutting down their working costs by reducing wages, salaries, advertising and other charges, or by greater efficiency in management, they will show less profit. Some of their expenses, commonly called overhead charges, they certainly will not have been able to reduce—such as taxes, rates, rent and other charges fixed by long contracts. Falling prices are thus a cause of disquietude and apprehension to the business organizer, and make the manufacturer hesitate about expanding his production; the merchant think twice before he takes more goods from the maker, and the retailer—the shopkeeper, from whom we ultimately buy—give orders less freely to the travellers who come to solicit them. It has been argued that falling prices, by thus making it more difficult for the organizer to earn profits, give him a stimulating flick with a whip and force him to improve his organization; and there is probably some truth in this theory. But being flicked with a whip is not pleasant to anybody and it is highly desirable that the people who do the

organizing job, which is of such immense importance to the trade of the world as a whole, should do it in a spirit of wholesome confidence and not be driven by a lash of apprehension.

When prices are rising, all is for the best from the organizer's point of view. His stock of raw materials shows him a profit before he begins to manufacture it, his stock of finished goods is in ready demand from the merchants who want to replenish their own before prices go further against them, and he is encouraged by the fact that prices are going the right way for him, to buy more materials, expand production, take on more hands, improve his machinery and generally to set the wheels of trade spinning faster. If the rise is not too fast, it probably helps him to do his work better. But just as we saw that falling prices act on him like a whip, so rising prices, if they go too far and too fast, are apt to make him fat and lazy and careless. During the time of the great inflation during and after the war it was waste of time to try to do business well, because anyone who had a stock of goods only had to sit and watch them rise in price and then pouch the fat profits that were assured by the mere rise in prices. That state of things is bad for everybody.

As a chronic borrower—for active business men can nearly always use more money than they, or the companies for which they work, actually own—falling prices are again bad for the organizer. If the boot-maker owes his bank £100,000, and expects to be able to meet the debt by selling 100,000 pairs of boots, and then finds when the debt is due that he can only get 17*s.* 6*d.* a pair for his boots because there has been a fall in prices in the meantime, he is evidently paying

back to his banker money which is more valuable, when reckoned in boots, than it was when he borrowed it. The fall may have been due to the conditions of the trade—more competition, inventions which have cheapened production or any of the other causes which tend to cheapen goods. But whatever be the reason, falling prices are bad, in some ways, for trade borrowers; and rising prices, which enable them to repay loans in money which has become less valuable than the money which they originally borrowed, are good for them; and when we remember that all the enterprising people whose initiative and driving power set and keep the wheels of trade and production spinning, are generally in debt to their bankers for temporary loans, and very probably also to investors for money lent for long periods on bonds or debentures, we see here another reason why they should want stability in prices, if they cannot have the rising prices which suit them best.

To creditors and investors, who receive fixed amounts from time to time in interest and expect to be repaid, some day, the money that they have lent falling prices are evidently a blessing, for they are continually paid in money which gives them a better command over goods and services. As long as the process does not go so fast that it ruins their debtors, they sit and see their "real" incomes—their incomes measured in goods and services—increasing through no effort of their own. But investors who are not creditors, but ordinary shareholders, who take their share of any profits that are left after all charges and interest payments have been met, are hit by falling prices and benefit by rising prices owing to their effects, already noted, on the profits of enterprise.

We thus see that price movements affect two great classes of people in opposite ways. One class, by far the more numerous, is composed of wage-earners, salary-earners, professional fee-earners, creditors, annuitants and all who receive payments which are more or less fixed. These want prices to fall as long as they can continue to earn or receive at the same rate in money. The other, much smaller but immensely important because their energy drives the wheels, want rising prices, and as long as the rise does not go so fast as to make them slack, will probably work better when they are prevalent.

An all-powerful monetary dictator, in the light of these considerations, would probably decide that, in so far as prices can be affected by the policy that he pursues in creating money, it would be better for everybody and more likely to produce stable conditions of business, if he kept the general level of prices steady. If he could do that, then neither of these classes would be either discouraged or made discontented owing to anything that was done by their money, and neither of them would be getting any benefit at the expense of the other. Steady prices, when once they have been restored to something like the 1926 level, which gave producers a chance of a living, are now generally recognized as desirable.

If, then, our supposed despot, ruling the money of all the world, came to this conclusion, how much could he do towards securing the ideal of steady prices all round? The answer to this question depends on the degree of importance to that we ascribe to what is called the Quantity Theory of Money, which tells us that the general price level depends on the relation between the quantity of money in existence and the

quantity of commodities that are being bought and sold.

Broadly, the truth of this theory seems to be self-evident if you think it over, and its truth was clearly shown during and after the war when a general increase in the volume of money, because the Governments of all the nations concerned found it easier to get new money created than to take it out of the pockets of their subjects by taxation, was accompanied by a general rise in prices, roughly corresponding to the increase in money. Obviously if we all found ourselves with twice as much money in our pockets and in our banks, and there were no more commodities to be bought, we should all feel nice and rich for a few minutes, but when we tried to spend our money we should find that its buying power had been halved, after much dislocation and adjustment, with benefit to some and loss to others. And, of course, *vice versa*—if the money of all of us were halved, we should feel terribly poor, but we should find that the competition of those who had commodities to sell would bring prices down, so that the community as a whole would be roughly as it was with regard to its command of necessaries and comforts, though the process of adjustment would hit some and help others.

It therefore seems to follow that if the monetary despot can keep the amount of money in roughly constant relation with the supply of commodities he could keep the general level of prices fairly steady, as long as the public which handles the money turns it over at a fairly uniform pace. This question of the " velocity of circulation " is one that we have to allow for before we ascribe too complete power to the quantity of money as an influence on prices ; and another rock

of which we have to steer wide, is the fact that when we expect the quantity theory to work "according to plan" we have to include among commodities many articles which are generally left out of the Index Numbers by which statisticians usually measure the general level of prices. A very interesting example of this difficulty was lately presented by the United States, where in spite of a great increase in the volume of money, as compared with the estimated volume of goods, prices of commodities were stable with a slight fall, in the years before 1929.

It thus appears that the power of a monetary despot to influence commodity prices by expanding or contracting the supply of money is by no means as complete and simple as it seems to be thought, by some of the people who assume that a stable price level is one of the boons that we can fairly demand from our central banks. It seems probable that they can certainly rely on their power to check a rise in commodity prices, by contracting the supply of credit, by raising its price, through advances in their official rates of discount, by putting difficulties in the way of borrowers and by reducing their holding of investments; but this is a weapon which has to be used with caution, since if wielded with a rough hand it might start a panic, which is sometimes easier to start than to stop. But the raising of prices by expanding credit is a much more difficult matter because banks cannot expand credit by advances unless they have borrowers to take them, and there are times when trade is so depressed that borrowers could hardly be tempted by the offer of money for nothing; and if central banks created credit by investment it might just lie idle, and money has to go to market and buy goods before it can affect their

prices. Still, the mere knowledge that plentiful credit is to be had cheap, may always have some effect in restoring the confidence of the enterprising organizer.

Moreover, even if a monetary despot could be certain of being able, like the man in Browning's poem,

> " his world to make
> To contract and to expand
> As he shut or oped his hand,"

it would not follow that the securing of a straight level of commodity prices would cure all the ills that trading flesh is heir to, as is too often assumed. By playing on the credit concertina, central banks could only affect the general average of prices, as marked by the Index Numbers. But an unaltered average price level may quite possibly be accompanied, for example, by a heavy fall in cotton offset by a sky-rocketing rise in copper ; and to the business man what is important is the price of the article or articles which he uses and sells as manufacturer or merchant. It is no comfort to him to be told that the general price level has, through skilful manipulation by a central bank, been kept on a nice even keel, if at the same time the violent rockings of his own particular commodity have upset his balance and his balance-sheet.

But when all this is admitted concerning the limits on the power of monetary authorities to control the average price of commodities and their inability to control the fluctuations of any one commodity, it is still clear that stability in the price level is a general benefit at which we can ask them to aim, as far as their policy and action can secure it.

And we are fortunate in having this ideal of stability publicly stated by a most distinguished exponent of

central bank policy as an object for which they ought to work. The late Mr. Benjamin Strong, Governor of the Federal Reserve Bank of New York, has already been mentioned as having done work which was of incalculable benefit to all the world in assisting the reconstruction of Europe and the establishment of international financial co-operation. He was also one of the brilliant team of monetary experts consulted by the Royal Commission on Indian Currency which issued its Report in 1926. He said in the course of his evidence: "We shall all admit that the object of perfecting monetary systems is the achievement of a stable domestic and international purchasing power for the currency—a goal unattainable by any one party acting alone and only possible through co-operative effort. Because a gold currency" (by which he presumably meant a currency based on gold) "is that one which has had in the past the most stable buying power both at home and abroad it is naturally the one which we all now seek to secure."

Governor Strong thus brings us to the second quality that we want from money—stable purchasing power abroad. This quality is of the highest importance to all who trade with foreign countries and so directly to all of us who consume foreign goods. Stability in rates of exchange was secured by the gold standard; and it has also been secured, to an extent which has had a favourable effect on the trade of the area in which it has prevailed, between the many members of the sterling group, which includes the British Empire and a large number of European and South American countries, and the United States, during a period of nearly two years. We want to see this stability extended and confirmed; and the promise of inter-

national co-operation, given by the American and British Governments when they intervened to ease the process of France's devaluation in September, 1936, was a hopeful sign.

It would also be much more comfortable for the business community if stability could be secured not only in the purchasing power of money at home and abroad, but also in the rate of interest that borrowers have to pay for its use. We have seen that nearly all active promoters of trade and industry are chronic or at least frequent borrowers from their banks, and upward jerks in the price that they have to pay for this accommodation are clearly inconvenient to them. If a manufacturer has embarked on an expansive programme involving a large amount of temporary credit, and suddenly finds that the price of it has been twisted up, he is likely to jump to the conclusion that there is something wrong with our monetary system, especially if he finds that his banker's charge has been raised to follow a rise in Bank rate and that the rise in Bank rate happened because our gold was going to America because high rates were being paid there for financing a wild Stock Exchange speculation.

It is easy to exaggerate the effect on costs of production of such fluctuations in the price of short credit, which are, in fact, almost negligible—it was stated by Mr. P. D. Leake, a distinguished accountant, in a letter published in the City article of *The Times* of Feb. 13, 1929, that "spread over industry as a whole, it may fairly be estimated that the raising of the Bank rate by 1 per cent. increases the cost of production by an amount nearer to 1*d.* per £100 than to 5*s.* per £100." Nevertheless, the effect on the minds and sentiment of

business men of rises in Bank rate, which have always been looked on as danger signals, indicating unsettled monetary conditions, may be very marked"; and it is most unlikely that industry and trade will ever again willingly submit to the rigours of the system by which the gold standard was formerly worked, when, in order to check speculation or exuberance at home, or because of panic or stupidity abroad, the whole community had to suffer the infliction of dear money.

CHAPTER XV

A NEW MONETARY WORLD

A HUMOROUS friend of mine, hearing that I was trying to revise this book, said, " You'd better call your new edition the Moaning of Money, for the monetary authorities are everywhere very much at sea, and not feeling at all well." They are certainly in a difficult position, with a new world, much of it still in a very bad temper, to be provided with currency and credit, and a new mechanism to be worked in supplying these conveniencies. Nevertheless, though the difficulties are great, and the sea on which they are uncomfortably tossing is full of shifting sand-banks and uncharted reefs, the means of control which the authorities have acquired by the creation of the new mechanism are at least more varied and extensive than they were, in the days when movements in Bank rate, combined with just enough " open market operations " to make such movements effective, were the only instrument used for regulating the supply of money.

Moreover, though there are so many new features in the monetary problem, it is very much, when we get down to the bedrock of the matter, *toujours la même chose.* In enumerating in the preceding chapter the qualities with which we ask our monetary rulers to endow our money, we were only setting forth those which man has always needed in any medium of

exchange and store of value that he has at any time used—stability in purchasing power at home and abroad and in the rate of interest at which borrowers can be accommodated. In other words, all that we want is money that will never be so scarce as to cause a fall in commodity prices sufficient to check production and enterprise, or so plentiful as to produce a blazing boom in commodity prices and a ramping rise in costs of production and of living, or so dear as to penalize expansion in business activity.

(Once more, it should be said that even if we secure all these advantages from our money, we need not expect that all the difficulties of enterprise will have been solved. Only those whose acquaintance with the facts of business life is superficial and distant, suppose that monetary causes are the only factor that rules its ups and downs. If business cannot see its way to earning profits the cheapest money, or money for nothing, will not make it expand; if it can see its way to profits, no stiff rate for money, as long as it is not so stiff as to eat up all the profit, will check it. But since variations in money rates are an influence on business sentiment, though not the sole one, and since business sentiment ultimately decides for expansion or contraction, it is important that the quantity and price of money should be regulated with skill, and with such foresight as can be expected from the very human beings that manage our affairs.)

Looking first at the advantages given to our monetary rulers by recent changes, we find:

(1) First and most obvious and apparently most revolutionary, is the abolition of the convertibility of the Bank of England note into gold, followed by the general abandonment of convertibility, or the pretence

of convertibility, in other countries, and the elevation of currency depreciation from an act of dishonesty into a respectable weapon of monetary statesmanship. This great change in law and sentiment apparently relieves the authority of any anxiety about the maintenance of the country's gold stock. But how much difference has it really made in this respect? Since we were forced off the gold standard, the Bank of England's stock of gold has risen to a height that would once have been regarded as enormous, and the Exchange Equalization Fund is known sometimes, at least, to hold a very large amount of the metal; these facts seem to show that a big gold backing is still thought necessary to maintain confidence in the stability of the pound. The only difference is, that whereas under the gold standard the Bank was obliged to keep a stock of gold sufficient to meet the demands of anyone who might bring it notes for conversion, it now has to keep enough, combined with that of the Equalization Fund, to meet the demands of any who may wish to convert pounds into foreign currencies. In other words, it has to protect our currency against a flight from the pound, either foreign or domestic; and a stock of gold, presumably convertible into foreign currencies, is necessary for this purpose. For though depreciation is now, under certain conditions, respectable, it might if enforced by demands for conversion due to mistrust, have uncomfortable consequences; and the maintenance of confidence in a country's currency by means of an adequate holding of gold is thus still an important part of the duty of banking authorities.

(2) This consideration also limits their apparently much greater freedom in varying the amount of the fiduciary issue note. Formerly, the limits on this issue

laid down by Peel's Act were regarded as part of the Ark of our monetary Covenant, and any attempt to alter them would have been viewed with grave suspicion; a suspension of the Bank Act being always associated with times of severe crisis—until the Great War came, such a thing had not happened since the Overend-Gurney crash in 1866 and even then the Act, though suspended, was not actually broken; and a 10 per cent. Bank rate was, by tradition, imposed as a matter of course by the Treasury as a condition precedent to the writing by the Chancellor of the Exchequer of the letter to the Bank in which he promised to secure from Parliament sanction for its violation of the law. Under the Currency and Bank Notes Act of 1928 all this formidable ceremony has been abolished, as mentioned on page 22. Thanks to these new powers, and the different sentiment now prevalent in the public mind concerning the limits on the note issue, the Bank of England and the Treasury can, apparently, vary as they please the amount of the legal tender cash which forms the basis of our credit system by raising or lowering the amount of the fiduciary issue. In fact, they have shown themselves very shy about doing so. It is true that they raised it, at the beginning of the crisis of 1931, from £260 millions to £275 millions and kept it at that level until March 1933. But in the middle of 1936 when French hoarding of Bank of England notes put many of them away in safe-deposit vaults (see *ante*, p. 218), no addition was made to the fiduciary issue, but gold was bought by the Bank to serve as backing for the increase in the circulation that was necessary; and again in May, 1937, when the Coronation caused a greater demand for currency, gold was again added to the

assets of the Issue Department, the fiduciary limit being unaltered.

Downward variation of the fiduciary issue only happened once before Hitler's war and was then, in December, 1936, accompanied by a slightly larger addition to the gold backing, as related on page 205, so that in spite of the fiduciary reduction the total note issue was not contracted but, to the extent of £5 millions, expanded. Evidently, the authorities are very cautious in using their widened control over the amount of the note issue. Their power to reduce it, if exercised, would be adverse to their policy of cheap money and would be resented by the business community as deflationary, and tending to lower prices and contraction of enterprise; but it may, perhaps, be used some day as a milder form of check than a rise in Bank rate on a too exuberant tendency to trade boom. Their power to increase it is limited by the fear of any measures which may be thought to be inflationary, so deeply implanted in the mind of Europe, owing to after-war experiences. This fear must be ever present as a check on the action of the authorities, since if aroused it might lead to loss of confidence and a flight from the pound. And so, in spite of the apparent freedom with which currency can now be created, the Bank and the Treasury still have to keep one ear on the ground and one eye on the groundlings, lest ill-considered measures should arouse fears, possibly quite unreasoning, in the minds of the man in the street.

(3) Another source of apparently increased power is the existence of the Exchange Equalization Fund, working in the profoundest secrecy and giving plenty of opportunity for manipulation by producing gold in

parcels of £65 millions like a rabbit out of a hat, with equal facility for burying it again out of sight if so desired. It has been stated by the Chancellor of the Exchequer in the House of Commons to have been worked at a profit; and at the end of June 1937 a corner of the veil that shrouds its operations was lifted. It was then stated to have held, at the end of the previous March, 26,674,000 fine ounces of gold, worth at £7 per ounce (then about the market price) £187 millions. In future the amount of its gold stock at the end of the previous quarter is to be published every half-year.

It was fortunate in the moment of its creation, for in 1932 and for some time after, all that it had to do was to prevent the pound from rising too fast, under the pressure of purchases by Continental operators, who mistrusted their domestic currencies, and preferred to turn them into sterling; sterling had gone through its crisis and was thought to be convalescent and in a healthier state than the dollar, owing to the banking trouble in the United States which was then boiling up into country-wide panic as related on page 77. Our Equalization Fund was thus enabled to check a too rapid appreciation in the pound by sales of sterling against foreign currencies and turn the latter into gold, either held in London or earmarked in the vaults of a central bank abroad. Its early operations were also assisted by the flow of gold in large quantities from India. The sterling required by the Fund for sale against foreign currencies it procures by the sale of Treasury bills.

For gold that it bought it paid the market price, which then ruled at about 140s. per ounce. When it sold gold to the Bank of England's Issue department,

it had to make good to the Issue department the difference between the market price and the fixed price of 84*s* 11½*d*. per ounce at which the Bank valued the gold in its Issue department. The Exchange Equalization Fund thus made an apparent book-keeping loss, against which there existed a reserve in the low price at which the gold stood in the Issue department's books. In other words, the Fund made a present, for the time being, of about 55*s*. per ounce to the Issue department for any gold sold to it and expected to get its present back again some day, when the gold in the Issue department was revalued in the light of modern facts, instead of being valued on an antediluvian basis, dating from the time of the old gold standard. This interpretation of these obscurities is confirmed by the *Economist*, which said in its issue of July 3, 1937, that the Exchange Equilization Account " debits itself with the recompense it pays to the Bank, but simultaneously credits itself with the profit that will ultimately arise from the re-valuation of the Bank's gold. That profit must for a moment be a matter of guess-work, for we do not know what the final price of gold will be."

All this is very ingenious and very confusing, but at least it can be said that the existence of the Fund has done much to check the activities of speculators in exchange, and has helped materially in maintaining during the past two years the *de facto* stabilization of the exchange rates of the pound and of the currencies included in the sterling area, and of the dollar. Now that France, Holland, Switzerland and the other members of what was called the Gold Bloc, have bowed to the inevitable and abandoned the gold standard in September, 1936, the further extension of

this *de facto* stabilization should be secured, and the fact that the United States and the above-named countries have followed our example in setting up Exchange Equalization Funds may make this object more easy of achievement.

At the same time, we must not too readily assume that the Fund is an ingenious device by which, thanks to its skilfully acquired holding of gold and foreign currency (if indeed it holds any of the latter) a drain on the Bank of England's gold was obsolete as a possibility. The Fund's assets, whatever they may be, had mainly been acquired owing to the influx of gold from India, which India might perhaps take back again some day, and also of what the City calls "bad-tempered" or "funk" money and Mr. Roosevelt has described as "hot" money—money that is, that has fled abroad in search of a temporary asylum, owing to fears of currency depreciation in the country of its origin, or of fiscal confiscation or of revolutionary upset or sometimes even of foreign aggression.

This being so, the assets of the Fund were needed for the special purpose of a safeguard against the possible return of this money and so could hardly be regarded as a buffer between sterling and any demands upon it that might arise owing to ordinary commercial or financial influences.

But the existence of this Fund has certainly brought one important advantage with it, namely the closer knowledge which its handling has enabled the authorities to acquire concerning the amount of foreign money at any time deposited or invested in this country. This knowledge cannot be expected to be either complete or exact; but it is very much more so than the information formerly possessed on this point.

(4) Concerning the closer control now exercised by the Bank of England and the Treasury over the discount market and the rates that it quotes, little need be added to what has already been said in Chapter VIII. Another detail, however, may be mentioned which increases this control. This is the division of Treasury bills into those issued week by week by tender, generally for the most part to the discount houses, and those which are in the market's phrase "on tap" and are supplied to Government departments. This variation, again, is novel in extent rather than in fact. At all times, before it was established, Government departments must have probably held a considerable proportion of the outstanding Treasury bills and it is only the large amount of this form of floating debt now in existence that gives the authorities an added power of making substantial changes in the volume of bills which the market has to carry.

(5) This power, however, gives our rulers yet another increase in control, in a department in which their influence is otherwise very effective, namely that of turning the stream of investment in the direction that they may happen to desire, which is, naturally, that of Government securities. In an article in its issue of May 8, 1937, entitled "our New Financial Machinery," the *Economist* said that by enlarging the credit base and simultaneously restricting the supply of Treasury bills the authorities can "force the banks into the long-term market as new competitors for Government securities." How far this forcing power really extends is, however, a matter on which one may be excused for feeling some doubt. Enlarging the credit base, as was shown above in discussing variations in the fiduciary issue, is an operation that is limited by

necessity to avoid fears of inflation; and though it is easy to restrict the supply of Treasury bills to the market as long as the Government departments are able to take them, it is by no means so easy to force the banks into long-term security investments, if the banks happen to think that such investments are likely to involve the unpleasant consequence, some day, of writing off depreciation on them. If that sentiment is prevalent, restriction of the supply of Treasury bills might force the banks into short-dated securities with no danger of depreciation attached; but the recent behaviour of Consols and of other undated and long-dated Government stocks has made the banks, always wary in investment matters, regard them with a cautious eye. A decline of 20 points in Consols, between January 1935 and April 1937, in a period in which a good market for Government securities was desirable from the Treasury's point of view, seems to show that its power to control the market is limited.

There can, however, be no doubt that the Treasury's influence on the security market and so on the rate of interest and the money market, has been greatly increased in recent years by the growth of the funds that it handles. In a paper read before the Manchester Statistical Society in February 1937 on Treasury Control and Cheap Money, Professor N. F. Hall calculated the total of these funds—National Health, Treasury Pension Account, Unemployment Fund, Post Office and Trustee Savings, Indian and Palestine Currency reserves, Public Trustee's balances, securities in the Issue Department of the Bank of England, etc.—at more than £1,000 millions. Professor Hall concludes, in this most interesting paper which is happily only the prelude of investigations to be carried con-

siderably further, that "it is hardly an exaggeration to say that the activities of the National Debt Office to-day determine the monetary policy of this country"; that this development has introduced a new element of guesswork into the business of banking and of short-term finance, and seems to have produced a position in which the stability of the gilt-edged market, internal monetary policy and to some extent the equilibrium of the national budget depend to a dangerous degree upon the volume of employment; and that under certain conditions a situation might arise which would require an "almost superhuman skill upon the part of those managing the national finances and a most unusual degree of confidence in their skill and judgment on the part not only of financial institutions in this country, but also of those abroad who carry sterling balances in the normal course of their business."

Another important power, and a really quite new acquisition, was the control, effective though without legal sanction behind it, exercised by the Foreign Transactions Advisory Committee, a body appointed to tell the City where it might, and chiefly where it might not, invest the funds that it handles for the public and for itself. This control had grown, as already mentioned, out of the Bank of England's embargo on foreign loans at the time when it was trying to screw up the exchange value of the pound so as to facilitate our return to the gold standard in 1925. Readily obeyed by the City, though not without a certain amount of growling, at that critical time, it naturally led the Bank to further efforts in the direction of rationalization in the investment market; and went on to regulate the borrowing activities of the municipalities, with a view to securing the orderly

marketing of their loans and the avoidance of competition between them and any issues which the Government might wish to place. At the same time, the embargo on foreign loans, though occasionally raised in special cases, has lately been revived, somewhat unnecessarily in view of the prevalent reluctance of investors to look at them, even if the issuing houses could be found to father them. (Since Hitler's war a Capital Issues Committee has extended this power of control over all forms of new issues.)

All these arrangements may have been an improvement on the unofficial control that was always exercised by the firms which specialized in underwriting new issues—that is, undertaking, for a commission, to take up any part of them that was not subscribed for by the public. But this notion of " planning " the investment activities of the City had an appetite which grew by what it fed on, and the appointment of this semi-official Committee, with a former Financial Secretary to the Treasury in the chair, resulted in a considerable extension of Governmental control of foreign investment; and what was considered the vagueness of its injunctions caused a good deal of exasperation, even in the tame and docile City of the between-war period. In March, 1937, it intimated that it was not only concerned with the regulation of new issues, but also with the use made of money raised by new issues. In answer to a question in the House of Commons the Chancellor of the Exchequer said that he concurred with the Committee's opinion that investment trust companies, making new issues, should confine the proportion invested abroad to " the minimum necessary to the conduct of the business in accordance with the

ordinary practice of investment trusts." But who can say what is the ordinary practice of these companies? Many of them do not publish any statement of the securities in which their funds are invested. Other regulations have since been divulged, widening the scope of control without reducing the vagueness of its directions. Still more absurd were the limits laid down for the conduct of their business by British houses which handled foreign investment, such as that they might accept and execute orders from their customers who might wish to invest abroad, but must not suggest such transactions.

How far these restrictions were effective, it is impossible to say. As was inevitable, they were respected by conscientious firms which thought it right to support the official policy, and ignored by others which regarded them as just silly; and, of course, they did not affect the many American firms which have branches here and have, in consequence of them, been enjoying an increase of business through supplying the facilities which the stricter British houses have refused to grant to their clients. There was much wrathful growling on the part of those whose legitimate operations were hampered; and quite disinterested critics of this new control pointed out that when the Kaiser's war came a big holding of American and other oversea securities was a most useful source of financial strength to this country; and further that such a holding is an efficient protection for the pound, if at any time its stability is threatened.

It is also amusing to note that while the authorities were thus trying to keep British money at home and the American authorities were devising plans for penalizing foreign money that invaded the United States,

American and other external operators were using the London Stock Exchange as a convenient casino, in which they could speculate without attracting the attention of their domestic tax-collectors. So much so, that when in April, 1937 a "gold scare" (as to which more anon) and a consequent collapse in commodity prices upset our Stock Exchange, realizations by American and Continental operators were said to be an important cause of the fall.

(6) It is also, perhaps, possible to assert that the prestige of the London market is even more effective than ever before as an asset in the hands of those who guide our policy. The fall of the pound from gold was certainly a severe blow to it, but its diminution was tempered by the determined struggle that was made to avoid the fall, and above all, by the calmness with which the crisis was faced by our banks and their customers and depositors. That the banks were able to open for business as usual on the day when the pound's fall was announced, and that the public, although it had been told that all kinds of horrors were bound to happen unless the pound could be saved, showed no sign of perturbation or tendency to turn their deposits into cash, struck foreign observers as an amazing proof of stability and confidence; and, as already related, in 1932 a stream of foreign money, pouring into London, enabled the Exchange Equalization Fund to start its operations under favourable conditions. Since then, though the monetary policy of our authorities has been plentifully criticized, it has shone like "a good deed in a naughty world," as compared with the fantastic performances of those of the United States, not to mention those of other countries which have had more excuse for monetary eccentricities.

At the same time, political prestige counts a good deal in the sphere of monetary respect; and here again we can claim, perhaps again rather owing to the contrast with political happenings abroad, a considerable growth in the envious admiration with which foreigners regard the stolid steadiness with which we muddle along in our political and social arrangements. Also, the merits of our constitution as a practical compromise, have been strikingly demonstrated by the enthusiasm aroused both at home and abroad at the time of first the Silver Jubilee and then the funeral of King George V and later in connexion with the coronation of King George VI, so perfectly staged and, for the first time in history, shared in by all the world thanks to the use of broadcasting.

(7) And now that the money market is practically a Government department, it may be possible to contend that it has a new weapon in the protective tariff into which we were forced by the policy of other countries in penalizing our export industries and dumping their goods on our market. It may be, now that we recognize that a sticky wage-system (with, let us hope, a rising tendency) is the best means to social and industrial peace, a flexible tariff, worked in conjunction with a flexible exchange value of the pound, and a flexible fiduciary note issue may provide our monetary authorities with more comfortable methods of maintaining stability than jumps and reductions in Bank rate.

(8) For the same reason, the great influence which Government exercises over industry can be used to stimulate and when necessary check our domestic activities, so affecting the exchanges and the demand for cash and credit. So far, this power has been used,

perhaps owing to the compelling force of difficult circumstances, in a manner which has not been altogether happy in its results. It is true that by encouraging house-building the Government at one time gave a useful stimulus to industry, but the demand that it caused for imported materials might have made the exchange position difficult had it not been for the influx of "hot money" from the Continent; and the rearmament programme, though a necessary and salutary gesture forced upon us by the tiresome habits of our neighbours, has produced an inopportune demand for labour and materials at a time when they were wanted to take advantage of openings, just beginning to show themselves, in the overseas trade, which it is so necessary for us to cultivate, if we are to maintain and improve our standard of life.

(9) Finally we come to the greatest advantage of all possessed by our monetary rulers of to-day, namely their consciousness that they have a difficult problem to deal with, and one which requires all the vigilance and intelligence that can be applied to it, if it is to be successfully solved. We have seen, in dealing with changes in the Bank of England's Court and staff, how much has been done to widen its range of experience and information. Our new Socialist Government has held out many promises which will take a good deal of fulfilling; and the abnormal length of the 1946–7 winter has made their task all the harder and will, we hope, stimulate its zeal.

Here is an imposing list of advantages now possessed by the rulers of our Money Market, more imposing at first sight than they are seen to be on close examination of the limits on their use. Extreme caution has to be used in applying any measures which might be

considered, rightly or wrongly, either inflationary or deflationary; control of foreign investment, if too rigidly maintained, hampers our export trade; public works paid for with borrowed money will, if carried too far, damage our financial prestige and depress the prices of our Government securities; and the tariff, if lowered, raises a storm of protest from all the vested interests, and, if raised, threatens a rise in the cost of production and of living.

We thus arrive at the broad conclusion that though the powers of the authorities are now much more varied for controlling the supply of cash and credit, they still have to be used with great caution; and that the essential features of the problem are not materially altered. As in former days, it is a question of providing the community with the right amount of money at the right price, without either encouraging exuberance or exaggerating depression in enterprise, and above all of maintaining the confidence of the public, domestic and foreign, in the prudence and skill of those who are, and are likely to be, managing this delicate job—now all the more delicate because of the new means provided and certain new difficulties now to be examined.

For against all these advantages we have to set some new features in the inter-war position which, until they were remedied or abolished, made it much more precarious than in the time of the old rigid pre-war gold standard.

(1) There was the existence of an enormous mass of "hot" or "bad-tempered" money, seeking refuge in the centres that were believed to be safe from fears of currency depreciation, revolution, confiscation or war. This, again, is a direct legacy of the Kaiser's war,

in the shape of political bitterness, international and local, and economic nationalism, expressing itself in trade barriers, exchange restrictions and other clogs on commercial and financial intercourse.

Exchange Equalization Funds act as a shock-absorber against the effects of this nuisance; but a real cure looks like an aspiration of a distant and doubtful future. If the policy laid down as their object by America, France and Britain in the statement issued by them in September, 1936, on the occasion of France's second devaluation of the franc, could be adopted, not only on paper but in practical fact, by them and by other countries, and if the world in general believed that this policy would be maintained and extended, it might exorcize the fear of currency depreciation—for it was a policy of collaboration both in exchange matters and in freeing international trade from its recent restrictions.

If this economic co-operation were real and widespread and were extended into the political sphere, and produced genuine peace after all these years of bickering and bitterness, the "hot money" problem —and most of our other bothers—would indeed be solved. Was there any chance for real peace? Mr. Olaf Hambro, chairman of Hambros Bank, told his shareholders on May 20, 1937, that "in spite of the revolting spectacle of the civil war in Spain, conditions in the rest of Europe have improved and are daily improving. Friendliness and confidence between the various peoples are beginning to manifest themselves." With the widespread connexions of his bank, Mr. Hambro was welcomed as a good judge; but he thought it necessary to add that "any happier relationship thus established is apt to be very sensitive to

articles in the Press." [1] History disproved his hope; but it is revived since Hitler's war and it is plainer than ever that without peace there can be no prosperity.

(2) Another modern cause of disturbance is the enormous scale on which speculation is now carried on often by people quite ignorant of the facts and conditions of business. Once more I have to rub in the fact this also is a legacy of war and of the high taxation which has followed it, inducing people to hunt for profits through Stock Exchange gambles, and also in the commodity markets. When the speculating public invades the markets in metals and materials and rushes up their prices at a time when they are badly wanted by industry, it becomes a serious nuisance; and its activities in this sphere seem to be less carefully controlled than they were —or were believed to be—on the Stock Exchange. During the boom in metals and materials in the spring of 1937, the City, with one of its pleasant exaggerations, related that at one time more than the whole existing stock of spelter had been bought (but not, of course, paid for) by the members of a West End club, not one of whom knew what spelter is.

A forward market in commodities is necessary for the protection of industrial users of them and speculation, on a moderate scale, helps to keep this market free and does no harm except, as a general rule, to the ignorant speculator. But the chairman of Goodlass Wall and Lead Industries was fully justified in attributing, in his speech on May 19, 1937, the "hysterical rise" in lead during February and March to speculative buying, and urging that "market conditions which made ordinary business transactions so hazardous were

[1] *The Times* report, May 21, 1937.

surely fundamentally wrong" ; and in sincerely trusting that those responsible for the London Metal Exchange and its regulations would be able to devise measures which would make impossible the events of the last few months. (*The Times* report, May 20, 1937.)

(3) In fact, the boom in commodities was checked and put violently into reverse, by a brick dropped by the American Government, which brings this subject of commodity speculation into close connexion with the monetary problem, and also brings us to the most formidable of the authorities' difficulties in dealing with it, namely their own remoteness from ordinary business life and ignorance of the sentiment of business organizers.

Early in April, 1937, just after Mr. Roosevelt had frightened the commodity markets with a quite correct and judicious statement that the prices of durable goods had risen too fast and that he intended to divert demand to consumable goods, a rumour got about which, in its most alarming form, credited the American Government with a desire to reduce its buying price of gold from 35 dollars an ounce to 30 dollars. The effect of this story was a violent collapse, not only in the commodity markets but also in the security markets ; because operators assumed that the consequence of any such action would be a heavy fall in commodity prices, bringing with it all the depression that, as was shown on page 231, is inflicted on profits and on business by falling prices.

Denials were quickly forthcoming and were repeatedly uttered during the succeeding weeks, that the American Government had any intention of making any change in its price for gold. It was also pointed out that the rumour was on the face of it absurd,

because under the existing law the President only had power to lower the price of gold by a few cents, the current price being equivalent to 59·06 per cent. of the gold content of the pre-Roosevelt dollar, and this percentage cannot, by an Act of January, 1934, be raised above 60 per cent. without the sanction of Congress. Nevertheless I have good reason for saying that the intention of making this violent change, which would have wrecked recovery in America and given it a smashing blow elsewhere, was actually cherished by the American authorities, or those of them who at that moment had the ear of the President.

In the light of this extraordinary event, the fact that the money market is now everywhere more or less a Government department acquires an uncomfortable significance. The pre-war monetary rulers may have been much less clever and well-informed than those of to-day; but at least they were ordinary business men, and as such knew the sort of effect that was likely to be produced on the minds of business men by any measure that might be proposed. How completely ignorant on this point Mr. Roosevelt's advisers were, is shown by the haste with which they pulled down their *ballon d'essai*.

And a still worse example follows, for it prevents our flattering ourselves that that sort of ignorance of public opinion could not be found among British administrators. While the world's markets were still reeling under Mr. Roosevelt's punch, our trusty Chancellor of the Exchequer landed British industry with another left-handed hook, in the form of a tax on the growth of profits, which not only demoralized the already staggering market in the shares of industrial and producing and shipping companies, but threatened

seriously to take the whole spirit out of enterprise. There is no need here to give any account of the criticisms showered from every quarter on this tax, which led to its withdrawal on June 2. It is enough to cite Mr. Keynes as saying, in a letter published in *The Times* of April 24, 1937, that the administrative and legal problems involved by it would "waste the time and energy of business men for years to come and involve all new plans in an atmosphere of uncertainty," and that "it is a tax on enterprise, growth and youth as such." But the important point for our present purpose is the proof that this ill-starred effort gave of the ignorance of our monetary rulers concerning the feelings of their subjects. Two days after announcing this tax, Mr. Chamberlain had to promise the House of Commons that he was ready to amend it, and pathetically observed that "it would hardly be in keeping with the policy he had followed ever since he had been at the Exchequer, to impose a tax of such a character as to repress, hamper and check industry and drive capital out of the country." (*The Times* report, April 23, 1937.) But this is just what the tax, in its original shape, would certainly have done.

(4) In this case public opinion was fully justified in being surprised and alarmed and disgusted. But its extreme sensitiveness to rumour and to all kinds of pessimistic suggestions is another feature in the present position with which the monetary authorities have to reckon. Owing to the wider distribution of wealth—one of the few good legacies left by the war—and the growth of a new and less experienced body of investors and the more widespread habit of speculation and the growing circulation of a popular press, expert in the use of arresting head-lines, monetary news and its

reactions are bruited abroad with thundering emphasis; and the public, with strong and dismal memories of the recent slump, and continually reminded that there is a theory about a trade cycle, which tells us that prosperity is periodically interrupted by recessions, magnifies this undoubted fact into a belief that a repetition of the recent slump, which was in fact unprecedented in violence and extent, is an inevitable feature of the more or less near future, and consequently is frightened by its present quite moderate prosperity, in the mistaken belief that the greater the prosperity the greater the inevitable reaction.

There is, however, plenty of justification for the greater sensitiveness of the public's nerves in these times, when we compare the many uncertainties of the present position with the rule of thumb stability of former days.

Then, one knew that the supply of money depended on the gold stock of the central bank, and movements of gold were evident and fully recorded; this dependence was not absolute and exact, but was regulated by authorities closely in touch with business sentiment, determined to maintain the exchange value of the currency and working by recognized rules.

Now, all these sign-posts have been smashed. Gold is hidden away in Exchange Equalization Funds, the operations of which the House of Commons has allowed the authorities to shroud in complete mystery, which has only been made rather less complete by the belated and partial publicity promised in June, 1937. This secrecy may be justified on the ground of the necessity for mystifying speculators; but it means another patch of darkness where light once was. Those who manage these affairs, either as politicians, or as officials

of a Treasury or of a central bank, are, from the nature of their occupation, less closely in touch with the risks of ordinary business than those who used to emerge for a time from ordinary business life to manage money matters and then return to it.

Then, London was the world's financial and monetary centre, working with English calm (which our critics say, perhaps rightly, is another form of English stupidity) and with English honesty (not yet smirched by an unpaid American debt-charge), and with English tolerance and respect for the point of view of others. Now, the best that can be hoped is international co-operation in leadership, under the guidance of a really disinterested international body.

Then, the price of gold was regarded as fixed and immutable, and with it, the gold points of the exchanges, subject to slight variations due to fluctuating rates of interest and costs of shipment. Now, the price of gold and rates of exchange are playthings of politicians; and many very intelligent people are convinced that gold and its value, now almost entirely based on convention, are doomed to disappear. As to that, only a highly civilized world seems likely to be able to dispense with the gold convention; and in the last twenty years the forces of barbarism, expressing themselves in Jew-baiting, book-burning, suppression of free speech and glorification of war, have definitely advanced. As Mr. Benjamin Anderson said in the Chase National Bank's Economic Bulletin of January, 1937, "gold remains the standard of value because neither men nor Governments will trust anything else. None of the stabilization funds of the various countries has any desire to accumulate any considerable volume of the paper currencies of other

countries. . . . The volume of gold hoarding in the world to-day is enormous because of the great damage which has been done to gold's greatest competitor, namely, the confidence that men have in the paper promises of governments and central banks."

Then, at least in pre-war times, there was enough gold, in existence and being dug out, to support a gently rising price-level and a steady expansion in world trade. After the war economists began to tell us that there was not going to be enough gold to go round, and that an era of falling prices and all the unpleasantnesses connected with it, lay before us, though a little common sense on the part of central banks might easily have made smaller gold stocks suffice. These forecasts have been falsified by the effects of the world-wide epidemic of devaluation, which, by raising the price of gold as measured in the devalued currencies, has enormously stimulated its output and made great bodies of ore profitable to treat, which had hitherto been regarded as unworkable. When an ounce of fine gold is sold at 140s. instead of 85s., gold-mining obviously becomes a quite different proposition.

Theoretically, the rapid increase in the gold supply ought to check itself by producing a rise in commodity prices that would raise the expense of gold-mining; and a further rise in commodity prices would have a beneficial effect on world trade by providing the primary producers with more purchasing power, and restoring equilibrium between prices of materials and those of manufactured goods and would also lighten the debt burdens of all nations. But after the Kaiser's war the monetary authorities were so terrified by the fear of inflation that the countries which received gold

"sterilized" it—that is, buried it and refused to allow it to produce expansion of credit—and, as we have seen, the Americans wanted to reduce the price of gold by one-seventh, in April, 1937, in order to reverse a rise in commodity prices which was certainly going too fast, but had not brought them up to the 1929 level. The effect of their proposal was such that they are not likely again to try to roast the pig by burning down the house; and the addition of £200 millions to the resources of the British Exchange Equalization Fund in June, 1937, was generally hailed as an indication that our Government was prepared to share with the United States the task of acquiring gold poured in by the movement of "hot money," and that no further proposals for tinkering with its price were likely to be ventilated. But the present position of gold, dug up in increasing quantities and poured into countries which have the largest stocks, while those which need it more cannot afford to acquire it, is anomalous and absurd; and until it is corrected by a revival of international trade and financing, it is another cause of doubt and uncertainty.

All this welter of uncertainty may be—must be, if economic civilization is to survive—a process of change from a faulty but practically workable system to something better and more scientific. With anything like a return to the old stability and confidence, what a world we might make! To win that, we must have real peace.

CHAPTER XVI

SUMMARY AND CONCLUSION

AFTER this long ramble through rough country, it is perhaps worth while to review and sum up the conclusions arrived at before they were further complicated by Hitler's war and what followed it, including the election of a Socialist Government. These complications will be dealt with in supplementary chapters.

Money, then, is the stuff with which we buy and sell things.

It consists, nowadays, of coins minted by Government, notes issued by the Bank of England and cheques drawn on banks.

Of these, Bank notes and coins are used for pocket money and small change, and cheques for larger transactions.

Bank notes, beyond the variable amount of the fiduciary issue, must be backed by gold, but are no longer convertible into gold. An adequate store of gold, however, still appears to be necessary to the maintenance of confidence in the stability of the pound's exchange value.

Cheques can be drawn to any extent that the banks may permit, by creating deposits by lending to customers and investing.

Since these deposits are payable on demand, the extent to which the banks can create credit is governed by the proportion which they think right to maintain between the cash that they hold and the deposits that they owe.

The cash held by the banks consists to a very small extent of silver or substitute coins but chiefly of Bank of England notes and the balances at the Bank of England that the other banks keep and treat as equivalent to cash.

Bank of England notes can be increased at any time beyond the legal limit by agreement between the Bank and the Treasury; and credits at the Bank of England can be increased through advances, discounts and investments made by it to an extent that is only limited by its discretion. It can also contract credit by open market operations.

Monetary management, once handled by business men, is now definitely a part of Government policy; recent changes in the Bank of England have made it more intelligent but more official; and the money market is now practically a Government department.

Since we want our money to be stable in buying power, and since the Quantity Theory of Money, which tells us that stability in prices depend on the supply of money keeping pace with the production of commodities, appears to be more or less true, we can ask our banking authorities to see, in so far as it is in their power to do so, that this relation between money and production is maintained.

Since fluctuations in rates of exchange and in the rate of interest are bad for business, we can also ask them to do all that they can to avoid these fluctuations.

Their power to provide these benefits has been in many ways strengthened by recent changes, but has been at the same time weakened by certain external and internal influences. The secrecy in which they shroud their operations and their lack of understanding of the possible effect of their measures, have created a

host of uncertainties for the bewilderment of those who have to organize and direct business.

But it must be remembered that the monetary authorities have been groping their way through great difficulties. They are very clever and very well meaning; and if those qualities can solve their problem, it will be solved.

CHAPTER XVII

THE FALL OF THE POUND

COMPOSED early in 1929, the previous chapter was bold enough to end with what it called a conclusion, pointing to the need for co-operation by the central banks of all the leading countries for the maintenance of the gold standard, described as essential for the preservation of stable rates of exchange.

This stability in rates of exchange made it certain that the moneys of the chief countries might be relied on to exchange into one another at prices varying only within narrow limits. It was shown in Chapter X above that at the date of its writing the pound was worth something in the neighbourhood of 124 francs; this meant that a British merchant, selling cloth or other goods to Paris for 124,000 francs, payable at some future date, could be sure that when the deal was completed he would be able to turn his francs into £1,000 or thereabouts.

In spite of this advantage that it gave to those engaged in oversea trade, the gold standard, even at that time, was subject to criticism from many voices, and, as was recorded on page 252, some doubters with high theoretical authority behind them regarded it as an obsolete barbarism. Since then, already modified by the Act of 1925, as shown on page 25, it has been abandoned by England and many other

countries, owing to a chain of causes which must be briefly reported, if we are to have a clear understanding of present conditions. Among them the most striking was the collapse in the autumn of 1929 of the boom in American securities which had been carried to monstrous heights in Wall Street. It had also been preceded and accompanied by reckless lending by American banks, finance houses and investors to other countries, especially those in Europe and Latin America, in the form of bond issues and short credits. It must be remembered that the Kaiser's war had caused the United States to leap, almost in the twinkling of an eye, from the position of a debtor country into that of world creditor and financial leader, without having acquired the experience necessary for learning the details of the job.

When the end of the boom came, Wall Street was besieged by speculators anxious not to be left holding the baby, and America's eagerness to realize securities and call in credits was quickened by apprehensions, fully and very soon justified, concerning the course of events in Europe. And so the international capital market, no longer a fertilizing stream quickening trade and consumption all over the world, became a morass into which claims for wealth were thrown pell-mell.

Then it was seen how one-sided was the system by which America's financial and commercial leadership had been guided. She had maintained and raised her high tariff on manufactured goods and subsidized her mercantile fleet, so making it difficult for her many debtors to meet the debt charges by the only sound method, namely, by the sale to the lending country of goods and of shipping and other services. When the lending process ceased the unfortunate debtors had

to try to sell their products at any price that they would fetch, and the tumble in the prices of securities was accompanied by a fall in those of commodities, disastrous to producers; especially to the "primary" producers, the farmers and miners and all who grow and dig for food, materials and metals, and cannot take measures for regulating output as readily as the manufacturers. In its *Commercial History and Review* of 1930, published in its issue of February 14, 1931, the *Economist* said: "The past year, then, will live in history as a black period both for Britain and for most of the rest of the world."

In fact, the blackness of 1930 was beaten by the blackness of 1931, the year in which England was forced by foreign panic to abandon the gold standard. The depression inflicted on the primary producers by the fall in commodity prices had reacted on the manufacturing producers, because the former were less able to buy manufactured goods; and when the collapse of the boom cut down America's buying power which had been artificially fed by profits earned in Wall Street, confidence in the banking systems of many countries began to be shaken.

Already in 1930 the seeds had been sown which brought forth such a crop of tares in 1931. For in the autumn of 1930 the world was startled by the "Hitler election." Leaders of the party to which it gave the chief voice in German policy had indicated their purpose, if they were given the power, to put the Versailles Treaty in the dustbin, and with it, of course, Germany's liability for Reparations, and also to make a vigorous start with the process of "soaking the capitalist." It was also known that they were inspired by violent anti-Semitic prejudice. And so

the run on Germany began which ended with the death of the gold standard.

As worked by England in the time of her financial and commercial dominance, it had, thanks to her free export of capital, the emigration of many of her skilled organizers and workers and, above all, her wide-open market for the goods and services of any country that could produce and sell them, helped to provide for herself and the rest of the world an amazing increase in prosperity. In this increase all ranks of society had shared, in spite of occasionally recurring crises, due sometimes to speculative exuberance, sometimes to wars and political disturbances, or the fear of them. Ups and downs marked the material progress of the world, but the ups were always more extensive and more permanently effective than the downs. The worst feature of these periodical reactions was the misery of unemployment that they inflicted on the wage-earners, an evil for which the true remedy is now being eagerly sought. But even they appear to have kept step in the general advance in welfare. In England during the century before the war of 1914 real wealth—that is, the command of the material blessings of life—enjoyed by each section of the community had been multiplied by four, according to an estimate made by the late Lord Stamp.

Under American leadership, with its "one-way street" in trade, free selling and restricted buying, plastered over with reckless lending, such growth of prosperity evidently could not stay a long course. When reckless lending gave way to ruthless realization of securities and calling in of credits, gold hoarding in France and the United States was another item in the witches' cauldron, and the weakness of the

American banking system began to show its effects. A great reform had established the Federal Reserve system to crown the edifice, but had left the foundation weakened by thousands of little banks, depending on the solvency of local industries, and bound to fail if called upon to meet their liabilities.

Attempts to stay the run on Germany, by means of a "standstill agreement," thus only had the result of encouraging the craving of the public in other countries for turning their bank deposits into some other form of security. As usual, it was in America that the most striking examples of this process were reported. The Washington correspondent of the *Morning Post* told stories of an old woman who had planted dollar bills in her cabbage-bed, a man who had concealed his money in a horse-collar and then found that the horse was eating the collar and was just going to devour the notes, another who had hidden his money in the stove, when a sudden cold snap caused his wife to light a fire which consumed the dollars, and so forth.

In Europe the same process, though of course on a much less magnificent scale, was afflicting banking systems wherever they had been developed, and hoarding of notes and even of gold caused those institutions which had safe-deposit facilities to let to be thronged by terrified hoarders. But it is high time to get back to England and the difficulties which forced her to lead the way in the abandonment of the gold standard.

It was in July, 1931, that the run on Germany became a run on London. England was the only country in which there had been no hint of banking weakness; but the disordered condition of the public finances had given critics a chance of accusing the

Labour Government then in power of heading the country for bankruptcy. Since then an unbalanced Budget has been accepted by high economic authority as a legitimate and praiseworthy measure, in certain conditions: but in those days, still under the influence of Victorian austerity, such a thing was regarded as a shameful blot on the national escutcheon.

So the country was severely shocked by the document famous as the May Report, from the name of its chairman, Sir George (afterwards Lord) May, an actuary of high authority. It told the country that in order to "produce a properly balanced budget in 1932, including the usual provision for redemption of debt, a deficiency of the sum of £119,000,000, say £120,000,000, has to be made good by fresh taxation or by economy."

This statement, which it called sensational, the *Economist* of August 8, 1931, attempted to correct. "The need," it said, "for radical retrenchment is so urgent that we sympathize with the obvious aim of the Committee to make the public's flesh creep. Nevertheless, for the sake of those who are not closely conversant with financial statistics, it is necessary to point out that this suggested figure of £120 millions deficit rather overpaints the gloom of the immediate budgetary prospect. The casual reader might deduce that actual national expenditure threatens to exceed actual national revenue by £120 millions in 1932–3. Happily, the position is not anything like as bad as that. For, accepting the Committee's own figures, £50 millions of the threatened deficit is accounted for by sinking-fund applications and £40 millions by borrowings for the Unemployment Insurance Fund, which the Committee—in profound disagreement with

the Chancellor of the Exchequer—insist on regarding as equivalent to Treasury borrowings for current expenditure."

It has been contended that the May Report was the final nail in the coffin of the old pound sterling and so of the gold standard, as formerly regulated. But there were other influences at work. American financiers had been trying to establish a discount market, on the English model, in New York and to undermine the prestige of the bill on London; and Mr. (as he then was) Snowden had indulged, in his Budget of 1930, in the process of "laying the burden on the shoulders best able to bear it."

Having to find £47 millions of additional revenue, he took the whole sum out of the big incomes and big estates, and was consequently accused by his political critics of penalizing capital. It is believed that these criticisms made British property-owners eager to send money abroad and also made foreigners who had placed money in England wonder whether it was as safe as they had believed; so that a flight from the pound may be said to have begun even before the May Committee had drawn its long bow.

Nevertheless, it is possible to cite high foreign authority for the view that panic abroad, due to political and other conditions in other countries, pushed England off the gold standard. Writing in the *Economist* of October 3, 1931, M. Charles Rist, a distinguished writer on economics and at one time Vice-President of the Bank of France, said: "The pound has fallen, like a good soldier fighting for the stability of the currencies of Central Europe. It was because London had a large part of its resources immobilized in Germany and Austria that it was

impossible during recent months to make good the withdrawals of foreign balances from London by calling in foreign credits. In a word, London was having to 'carry' not only its own currency, but that of a large part of Europe. The pound fell as a result of unjustifiable panic; the forces which led to its fall were largely external to England."

It is, however, true that M. Rist quickly exercised that privilege, so often indulged in by our economic teachers, of changing his mind with a sudden jump; and published an article in *L'Information* of January 21, 1932, in which he blamed England with having caused the whole crisis, the flight of gold to America, America's reckless foreign lending, stock-market boom, etc., by her ill-considered action in trying to force the pound back to its old gold parity instead of devaluing it in 1920. It is now fairly generally agreed that this action was too ambitious or carried out too soon; but at least it was prompted by considerations of common honesty. For though a country certainly has a legal right to say at any time that its money is convertible henceforward into a smaller sum in gold than before, by exercising this right it is in fact robbing its creditors who had left money in its charge fully believing that if they wanted to bring it home it would be worth as much, in gold or other currencies, as when they deposited it. And in those days, England had not yet joined the ranks of the defaulting governments.

But whatever the causes of the run on London, England made every possible effort to defend the pound. In July, 1931, the Bank raised a credit of £50 millions in Paris and New York. When this dose, that looks so small in these days of astronomical

figures, failed to stay the plague, Ministers were summoned from their holiday retreats, and measures began to be talked of for balancing the Budget, for the reassurance, it was apparently believed, of possible foreign lenders, though in fact unbalanced budgets were an epidemic disease then raging in most countries. This meant the end of the Labour Government, most of the members of which opposed the reduction of unemployment benefit. On August 24 a new Government was formed representing a coalition of all parties, and Parliament was summoned on September 8 to turn over a new leaf in the direction of economy, and on August 28 it was announced that the Government had secured a credit of £80 millions in New York and Paris.

England had thus done her level best for the gold standard; she had changed a Government, which had certainly been extravagant, but no more so than those of the countries which were trying to help her over the stile, and there was no doubt that her new one would take a step that to many of her inhabitants seemed even more shocking than the fall of the pound, and give up the policy of free trade, imposing protective duties in order to correct the adverse balance of trade which was weakening her international position.

These new leaves turned over by England's rulers should surely have stopped the run, if it had been due to British mistakes; but the run in fact went on all the faster, because our foreign creditors were afraid that if they did not get hold of their money before the credits were used up, they might never get it. Expectations of a General Election increased uneasiness at home, and a prodigious effect was produced abroad by

a refusal of duty by a few sailors, dissatisfied by a cut in their pay, imposed on them by the new Economy Bill. A story, surely too good to be untrue, was current at the time which related that owing to a small arithmetical mistake by a clerk in the Admiralty, the cut objected to was more severe than those inflicted at the same time on other members of the fighting forces, and so was justly resented by the sailors. If so, this arithmetical slip was one of those small events which warp the course of history; for foreign onlookers, with their minds full of memories of naval mutinies at Kiel and Petrograd which ushered in Russian and German revolutions, were hastily convinced that the whole British Navy was in revolt and that the doom of the British Empire was sealed. Their memories did not go back to a very real mutiny at the Nore, which happened almost on the eve of the Battle of Aboukir, in which Nelson destroyed a French fleet. And so the effect of the action of a small number of disgruntled sailors was such that a vigorous English opponent of the gold standard was able to exclaim that our Navy had once more saved the country.

These things happened in the middle of September, 1931, accompanied by panic on the Continental Bourses and in Wall Street and withdrawals, with a strong crescendo movement, of foreign money from London, which had paid out more than £200 millions since July. To requests for further assistance the American and French governments returned sympathetic but discouraging replies. The Bank's remaining stock of gold had to be held for repayment of the credits already granted; and so, on September 21, 1931, the Bank was released by Parliament from its duty of meeting its notes in gold on demand.

Much more effect was produced abroad than in England by the collapse of the pound. The calmness of the British public was astonishing. It had been assured by responsible statesmen that unless the pound was saved all kinds of horrors would happen—runs on banks, a rocketing rise in prices, hoarding of food, all the symptoms of wild inflation. In fact, when all the British banks opened as usual on the day after gold payments had been suspended, there was no sign of any abnormal demand for cash by their customers. Instead of a rise in prices in the shops, cheap bargains began to be offered owing to hurried imports of goods by foreign sellers anxious to get them in before the expected tariff wall was set up; and so the domestic consumer found that the fall of the pound had been good for his pocket and his, or her, flesh refused to creep when they were told that they were suffering acute hardship. When a political candidate brandished a pound note before a meeting and stated that it was now worth only fifteen shillings, a working man retorted, "I'll give you fifteen and six for it." A General Election in October gave Mr. Ramsay MacDonald's coalition Government the biggest majority on record.

With the consumer thus for the time being contented, British industry was freed from many of the handicaps imposed on it by the too rapid forcing up of the pound to the pre-war parity in 1925. The exchange value of the pound was quickly lowered—from 4 dollars 86 cents odd, it now fetched only about 3 dollars 50 cents, with the result that Americans selling goods for £100 here only got 350 dollars for them, and those who bought £100 worth of goods here got them for 350 dollars. So England became a

good country to buy in and a bad one to sell to; and when the expected tariff on imported goods was introduced, industry was freed from the competition of dumped goods poured into Britain by countries which raised all possible obstacles against her exports; and an attempt was made to guard against the worst danger associated with a tariff—that of log-rolling and corruption among politicians, "out for a slice of tariff pie" for their constituents—by the establishment of a Tariff Advisory Committee, freed as far as possible from Parliamentary influence.

But industry was hampered by other difficulties besides foreign dumping, some of them due to its own slackness and complacency, inherited from the fat Victorian period before it had to face the competition of other countries, which had been growing for half a century and had been greatly stimulated during the first great war. High taxation (though it looks so mild when we look back on it now), stiff local rates, high wages (as they were then considered), trade-union restrictions and "demarcation strikes," and in many industries obsolete plant and weak management, were handicaps that no tariff could correct, though it gave a chance to industry, now partially shielded by it, to raise the capital needed for reconstruction.

Nevertheless, the fall of the pound was followed by substantial improvement, in spite of a stiff Bank rate —6 per cent.—apparently imposed by the Bank of England as a warning to the country not to indulge in exuberant speculation. The President of the Board of Trade, in a speech delivered in April, 1932, said that between September, 1931, and March, 1932, the number of workers actually employed had increased by 250,000 and that forty-three new factories had

been started to produce goods such as knitwear, ribbons, furniture, leather goods, clothing, etc. The *Economist* grimly rejoiced with the President " at these patches of improvement in an industrial picture still blackened by the plight of coal, iron and steel, engineering, shipbuilding and shipping " and pointed out that he had omitted to mention that in proportion as Continental goods had been shut out of our markets by tariffs, Continental capacity to buy British exports had been reduced. " By applying his famous ' slimming process ' to British trade, he has automatically tightened the thongs which are slowly strangling the trade of Europe."

Moreover, the depreciation of the pound, as marked by the foreign exchanges, soon ceased to give that assistance that our trade had at first gained from it. Foreign operators quickly began to parry its effect by fiscal devices and also by purchases of British money, especially after the Bank rate had been brought down, in the first half of 1932, from 6 to 2 per cent., and the splendidly successful conversion of the £2,000 million 5 per cent. War loan had made it into a 3½ per cent. stock, and shown the way to the cheap-money policy which has lightened the burden of the enormous cost of the second great war. In 1932 the average dollar value of the pound was 3 dollars 50 cents, but by 1934 it had soared well above the pre-war parity of 4 dollars 86 cents, and averaged 5 dollars and a fraction; this appreciation of the pound had been assisted by Mr. Roosevelt, who had, in the meantime, entered on his momentous tenure of office as President of the United States, had closed all the banks in his country for four days, cut in half the gold value of the dollar, and suspended dealings in exchange.

Thus he effectively countered the competitive benefit that was supposed to have been secured for England by the fall of the pound. A wit of the time said that while England had been pushed off gold, America had jumped off it. Mr. Roosevelt's measures gave some encouragement to American business and might have led to general recovery, but unfortunately they were followed by uncertainty as to what this bold experimenter would do next and also by his attitude towards the American business leaders. There was plenty to be said against the manner in which some of them had carried out their task, but they were penitent and ready to behave better, after the terrific castigation which their own misdeeds had inflicted on them, if they had been kindly treated. But Mr. Roosevelt made no attempt to secure their confidence; and under a system of private enterprise business revival is impossible without the co-operation of those who organize it and take its risks.

Between 1933 and the beginning of the war in 1939 the most notable and unfortunate event in international finance was the default by England on her war debt to America, a fact which has done so much to stimulate the activities of the isolationists on the other side of the Atlantic and put such a useful weapon in the hands of those who opposed the granting of the loan to England in 1946. In the *Sunday Times* of May 12 a message from Washington, recording the clearing of "its first great hurdle" by the British loan, which had received the approval of the Senate on the previous day, added that it is "regarded even by its best friends as an uncomfortable necessity, while its opponents vigorously denounce perfidious Albion." It is queer to see this jibe cast some 150

years ago by Bonaparte at the indomitable foe who finally wrecked him, now echoed by Americans against the ally that had borne unaided, in the first years of the last war, the brunt of the German attack.

But our American critics have a good deal more reason than the Corsican. We had borrowed—"hired the money" as Mr. Coolidge said—some £1,000 millions during the Kaiser's war and it was then our boast that a debt was a sacred obligation; it is idle to pretend that the concern of America in victory was as close then as it was in the Hitler war, when the development of air forces has almost abolished time and space; and at the time when we defaulted on the debt we were congratulating ourselves on a thumping Budget surplus and rejoicing in sixpence taken off the income tax.

It is important to remember these things, for there is a good deal of unnecessary resentment here about the American attitude towards the loan and about the conditions attached to it. Some reason there is for resentment on this latter point, on which more will have to be said later. But American taxpayers surely had reason to feel sore, when they had to meet the charges on the loans raised by their Government to find money for helping England against the Kaiser, and then saw the debtor ceasing to meet his obligations and dulling the edge of the tax-clipping shears.

It has been contended that America, by her monstrous tariff on manufactured goods and lavish subsidies to her mercantile fleet, made it "impossible" for us to meet the debt charge; but at the time of our default, plenty of goods were going free of duty into the United States, such as rubber, tin, tea, etc., not to mention gold, of which two of our Dominions were

then the largest producers. It is most important, in view of the need for co-operation by the English-speaking upholders of liberty and international good-will, that we should not make too much of criticisms that we have done something to deserve.

CHAPTER XVIII

THE WARTIME BULGE

WHEN Hitler's war threatened the destruction of such civilization as the world had hitherto enjoyed, the London Money Market was in good shape for doing the huge job that it was called upon to tackle. All that it had to do was to blow itself out and bulge. Until then it had been doing its best as handmaid of industry and commerce. Then, it had to act as handmaid to a Government that was calling on the nation to put its last ounce into fighting for its life. The market rose to the occasion, on the whole, as was to be expected, though sometimes with an undertone of grumble—a cross-grained old charwoman rather than a willing handmaid, resenting the demands made on her, but carrying them out.

In its outward aspect it is just as it was, with the Bank of England at its head, surrounded by the Clearing banks (namely, those that are members of the bankers' clearing house) with the discount houses supplying them with bills of the kind and date that they prefer and borrowing money from them for carrying others, and the Stock Exchange providing a market for securities and, at one time, a lodging-house for a part, usually quite small, of the banks' available money.

In most of these components of the market the

bulging process has been on a generous scale. The Bank of England's return of May 8, 1946, showed that in its issue department the notes in circulation had swollen from £369 millions odd (shown in its return of July 3, 1929, given on page 229 above) to £1,342 millions, with a corresponding increase in the "other Government securities" from £235 millions to £1,388 millions, while the fiduciary issue had grown from £260 millions to £1,400 millions. On the other hand, the stock of gold coin and bullion has been reduced, by transfers to the Exchange Equalization account (to be explained later), from £155 millions in 1929 to about a quarter of a million in 1946. In the banking department, the public deposits have actually been halved, from £28 millions to £14 millions; but the bankers' deposits have risen from £76 millions to £226 millions, thus affording to the Clearing banks the necessary foundation of so-called cash for the growth in their liabilities.

This growth was analysed by an article in the *Economist* of July 7, 1945, on "Bank Deposits in wartime." It showed that those of the London Clearing banks had been just doubled between August, 1939, and May, 1945, having risen from £2,177 millions to £4,483 millions. Investments had increased from £599 millions to £1,126 millions and Treasury Deposit Receipts (as to which more anon) had sprung out of nothing to £1,881 millions. Bills had declined from £279 millions to £120 millions, and loans to the money market had risen from £147 millions to £196 millions. These changes the *Economist* summed up by showing that the banks' wartime purchases (or financing of purchases) of Government securities had added up to a total of £2,298 millions. Advances—those loans to

industry and commerce which had once been the most profitable asset of the banks—had fallen from £985 millions to £749 millions and the holding of cash was doubled at £482 millions. This enormous increase in their turnover and responsibilities had been handled by our banks with no reduction in the facilities granted to their ordinary customers, apart from a slight shortening of the hours at which they were open to the public. This gigantic effort was made by the banks with their staffs depleted by conscription, though reinforced by very efficient ladies, highly conscientious and eager to show that for the purposes of detail banking work they were "just as good as a man if not better." When we compare the manner in which we middle-class folk, with our tiresome little cheques that cause just as much trouble and book-keeping as drafts for thousands or millions, had our banking promptly and accurately done, with the long delays and occasional mistakes in the delivery of letters and parcels, we may surely take off our hats to the women who came to the rescue of the banks.

With the discount houses the problem was different. They had already, to a great extent, been relieved from their task of collecting and appraising bills based on oversea trade, and been faced by the simpler problem of encouraging and developing the use of inland paper, in so far as internal production for pre-war rearmament was not financed directly by the Government. The bulge in their turnover was provided by the great growth in the volume of Treasury bills, in financing which they were judiciously helped by "open market operations" by the Bank of England, using its "hidden hand," as noted above on page 195, to relieve the bill-brokers of the need to borrow from it. This method

of helping the discount houses round awkward corners has been made much more pleasant for them during and since the last war. Instead of having to apply to the Bank of England for advances, whenever the Clearing banks or other lenders called in from them more money than they could spare, and paying for this accommodation Bank rate or something over, they are now waited on daily by an emissary from the Bank who inquires what assistance they need and duly supplies it, by buying back from them Treasury bills at, or a shade above, the price that they paid for them. Thus the hidden hand has ceased to be hidden, and the discount houses have been enabled to widen the market for the short-dated bonds with which the war has been so largely and so cheaply financed; to make it easier for reluctant bankers to swallow doses of Treasury Deposit Receipts; and generally to keep the market working with as little disturbance as possible.

Their utility in this respect has been increased by their being allowed, and encouraged by the Bank of England, to make large additions to their capitals at a time when issues of capital were jealously restricted, and several of the private firms blossomed out into public companies, some of them after joining forces by amalgamation, also officially encouraged, up to a certain point.

Thus consolidated and strengthened the discount houses have also, since the war, expanded considerably their activities in handling commercial bills, some drawn against imports of tobacco, some against exports of British goods, such as textiles which the manufacturing firms are unable to complete owing to lack of the necessary labour, some against furs which, for the same reason, have to go abroad to be "processed,"

and some against the India bills that were once so popular in the market and are now reappearing against shipments of goods sometimes on the way to Australia, America or elsewhere—an interesting revival of the system by which trade between oversea countries used so often to be financed by bills drawn on London.

In the case of the Stock Exchange a very definite change was enforced on its business activities, dealings being restricted to bargains for cash. Its old machinery of carry-over, contangoes and backwardations [1] was put for the time being on the scrapheap and has not yet been restored; and its activities have also been hampered by the establishment of a Capital Issues Committee which, in September, 1939, gave statutory force to the restrictive power, formerly exercised through hints from the Bank of England, concerning the use and criticisms of which, at the time when we were struggling to return to the gold standard, mention was made on page 225 above.

Official control has thus been legalized and made tighter, and like all similar measures been resented by those affected. And, apparently, with some reason, as holding up trade and development when they are most urgently needed, if the nation is to deal with the grim task that lies ahead of it. In the *Sunday Times* of April, 1946, Mr. Norman Crump, its City Editor, pointed out that during recent weeks several proposals to make new capital issues had been dropped at the last moment, because, "acting in accordance with Government policy, the Capital Issues Committee had insisted upon too high a price. In some instances the companies concerned have been able to secure new funds from their bankers or elsewhere, but there is

[1] Explained in *Stocks and Shares* by H. W. (John Murray).

reason to fear that in other cases the development project for which the new capital was required has been dropped. If so, the net result has been a retardation of the nation's industrial progress."

Controls of various kinds, however, are an inevitable feature in the policy of a Socialist Government, and at least it can be claimed that by maintaining strict control of the capital market, our present rulers, adopting the practice bequeathed by their predecessors, have secured that lower cost of Governmental borrowing which was so marked in the recent struggle. During the war of 1914–18 the Treasury was deluded by the City into a belief that every loan offered must bear a higher rate of interest than the last, until finally an issue of 6 per cent. Exchequer bonds marked the discreditable climax of a purblind policy. Hitler's attack was met by a series of issues of which none offered a higher rate than 3 per cent., and most of which consisted of Treasury bills generally yielding less than 2 per cent., and often less than 1 per cent., and of issues of Treasury Deposit Receipts, explained by the *Economist* of July 6, 1940, as deposits accepted by the Treasury through the Bank of England, from Clearing and Scottish banks, of six months' currency and carrying interest at 1¼ per cent. (since then reduced to ⅝). The lending banks may require repayment before the due date, subject to rebate at Bank rate. Money so deposited goes straight to the Exchequer and does not appear in the Bank return. The cash requirements of the Treasury are made known to the banks every Friday, and the deposits are made in units of £500,000.

This new feature in the Money Market landscape is merely a variation in form of the long-established habit by which Governments have provided themselves and

the public with purchasing power by borrowing from banks.

So far, all that has been recorded as happening to the Money Market and its satellites has consisted of developments or adaptations of its earlier history; and even the next event to be chronicled—the nationalization of the Bank of England—does little more than make statutory the connexion, already long established, between the Bank and the Treasury. The shareholders were bought out, on terms generally recognized as fair, and the changes introduced by the Bill, brought in in October, 1946, with regard to the term of office of Governor and directors, and the number of the latter, have called for little criticism. Governor and Deputy are to serve for five years—a great improvement on the once-upon-a-time two years and the twenty-five years that Mr. (now Lord) Norman so nearly completed—and the directors, now reduced to sixteen, for four years, and all are to be appointed by the King, that is by the Government of the day. The reduction in numbers of the Court had already been carried out or anticipated by retirement of senior members; and Lord Catto, who succeeded Lord Norman in 1944, remains Governor. He had acted as financial adviser to the Treasury since 1940, but before that date had had a long and highly successful career as a business man, which began at the age of 16 in a Newcastle shipping office, and took him to the Near and Far East three years later, and afterwards to the United States, and so back to London, where he became a partner in the firm of Morgan Grenfell & Co. and a director of the Bank of England and other banks. All these positions he resigned on becoming adviser to the Treasury.

Power was also given to the Treasury, after consultation with the Governor, to "give directions to the Bank," a very slight underlining of the influence that the political authorities could always exercise on the actions of the Court on those rare occasions when they chose to use it—a power inherent in the fact that the Bank's charter is subject to periodical revision. Another, apparently slight but possibly dangerous, accentuation of an already dimly existing fact, is a clause in the Bill which enables the Bank to request information from, and make recommendations to, other bankers, and further, if authorized by the Treasury, to issue direction to any bankers for the purpose of seeing that effect is given to these requests and recommendations. It is, however, provided that "no such request or recommendation shall be made with respect to the affairs of any particular customer."

This is an important safeguard of the right of a bank to treat its relations with its customers as strictly confidential; but the power of the Bank of England, henceforward in fact a Government department, to tell the other banks how to conduct their business, carries with it dangers in the future (remote, we may hope) if ever a Government comes into being, imbued with extravagant convictions concerning currency creations as short cuts to prosperity and happiness, or eager to further political objects by monetary influences.

Against such inflationary dangers, however, there is at present a stout shield in the existence, created during the last thirty years, of a great mass of comparatively poor holders of Saving Certificates, Post Office deposits, and other Government obligations. In his Budget speech on April 9, 1946, the Chancellor of

the Exchequer said that his task had been made much easier by the splendid tenacity of the National Savings movement, which had pledged themselves to find, during this coming year, £520 million of new money in the form of small savings. Mr. Dalton added that with this reinforcement of our finances by the Savings movement (the probable fulfilment of which has been offset by realizations of other forms of "small saving"), he would not need to borrow any very large sums from the City during this financial year, so freeing the Money Market for supplying the needs of local authorities, public boards and the whole range of private industry.

Since the starting of the Savings movement thirty years ago, the total of small savings is calculated to have grown from some £314 millions to about £5,585 millions at the end of March, 1946. It is a splendid achievement carried out in the teeth of a common prejudice against thrift as a rather mean habit; and if tribute is due to those who have provided the total—who after all have got a very good investment in return for their sacrifice of immediate spending—a much heartier tribute is surely owed to the thousands of earnest missionaries, many of them already overworked teachers in overcrowded schools, who have devoted their scanty leisure to preaching the gospel of saving, forming saving groups and organizing the competition among them, which has brought in the sporting instinct as a useful stimulant.

Besides these continuations and expansions of existing institutions and policies in the money market—for even the successful use of cheap money to keep down the cost of the debt had been tested and proved in 1932 by the conversion of the £2,000 million 5 per

cent. War loan—the next item in this record may be said to be a real novelty, for it consisted in the foundation early in 1945 of two new concerns, the Finance Corporation for Industry and the Industrial and Commercial Finance Corporation.

The first, as explained by the Chancellor of the Exchequer in the House of Commons, was to have a capital of £25 millions subscribed by insurance companies, trust companies and the Bank of England, and borrowing powers of £100 millions, provided by the Clearing banks and Scottish banks. It is to provide temporary or more permanent finance for industrial businesses "with a view to their quick rehabilitation and development in the national interest," but it will not itself reorganize industry.

The second, with a capital of £15 millions and borrowing powers of £30 millions, provided by the Clearing and Scottish banks, is to supply medium- and long-term capital for small- and medium-sized businesses in amounts from £5,000 to £200,000.

Both are to be independent units with their own boards and staffs, and, "in order that the policy adopted by them may conform to the general economic policy of the Government, the appropriate Government departments will be kept informed of the nature and extent of all major developments being considered by the companies." They are to conduct their operations "on the broadest possible lines consistent with reasonable commercial prudence."

As to this last-mentioned provision, it was observed by the City Editor of *The Times* that there might be some temptation to ask whether there is in fact much industrial business which is commercially prudent but none the less cannot be handled through existing

channels; but he decided that it was easy to imagine such cases in the post-war world. He also pointed out that there are already two large financial concerns operating as specialists in this field, and others besides who in fact finance small enterprises as part of a general business.

This interesting addition to our financial machinery, started by the late National Government and encouraged by the Labour Ministry which succeeded it, appears to be designed to fill the gap which existed in that machinery, in the view of the Balfour Committee, as recorded above on page 124 and later of the Macmillan Committee which reported in 1931. Both these bodies, manned by distinguished theoretical and business experts, noted the closer connexion in other countries between industry and banking and especially in Germany (as German banking found to its cost when acute industrial depression came), and though they did not suggest that our banks and industry should knit themselves together more closely, they thought that there was room for some institution which should provide longer credits than the banks approve and should attend to the needs of small enterprises.

Since then a Government department has undertaken the partial insurance of long-term export credits; and with regard to the financing of small businesses, it was contended, at the time when this subject was being discussed, that all really sound business of this kind was readily done; and many instances were quoted of losses incurred by banks in trying to meet borderline cases, where the borrowers had plenty of experience but no money, and ended by providing the banks with experience and relieving them of money.

But, as the City Editor of *The Times* pointed out,

in this post-war world there may be room for special measures, and it will be interesting and instructive to see what practical results are produced by these two new concerns in competition with those already at work in the field that they propose to cultivate. As was only to be expected, their opening performances were not too encouraging; but seemed to indicate that they were supplying a "felt want." And in the interest of consumers, and of the elasticity and growth of industry, the encouragement of young enterprises is all important.

CHAPTER XIX

PEACE-TIME PROBLEMS

IN the interval between the fall of the pound in 1931 and the passing on July 13, 1946, by the American Congress of the agreement, already accepted by the British Parliament, for a credit to be granted by America to England, the task of the rulers of the London Money Market was comparatively simple. A Tripartite Agreement, including America, France and England, obliged them to do their best to keep rates of exchange steady and so to maintain an even balance between the interests of foreign trade and domestic enterprise. But they were under no obligation to watch over that convertibility of Bank of England notes into gold on demand, which was once supposed to be the ark of the covenant of British solvency and credit; and to safeguard it by changes in Bank rate, sure to be distasteful to some elements in the business community which were represented on the Bank Court. The working of the gold standard, so often described as "automatic," must in fact have caused many uncomfortable moments to the Governors who handled it, especially at times when the autumnal drain of gold to pay for oversea cereal crops threatened to make the Bank's stock of the metal look too small. So far was their action from being automatic, that at those seasons there was often free betting in the Consols market on Thursday mornings concerning the decision of the Bank Court; and a cheer would welcome

the arrival of the Government broker with a message of "no change" from the Bank, so postponing, at least for a week, dearer money with its usually adverse effect on business.

"Good-bye to all that" came with the fall in the pound. Convertibility of notes into gold was no longer a cause of anxiety and convertibility of British money into other currencies was controlled through the creation in 1932 of the Exchange Equalization Fund. The Budget of that year gave the Chancellor of the Exchequer power to borrow £150 millions to enable the Treasury, acting through the Bank of England, to acquire gold or foreign exchange, so as to neutralize the effect on the exchanges of movements of floating capital. The Fund was provided by issues of Treasury bills and was used for buying and sterilizing, for the time being, invading gold or foreign currency that threatened to raise the exchange value of the pound too fast, and for selling them if the exchange wind shifted.

This Fund bulged like everything else in the Money Market; and its swelling total, the sum of which has been kept secret during and since the war, enabled our authorities to achieve something like the steadiness in exchange rates that prevailed in the time of the gold standard, the New York exchange being "pegged" during the war and other rates being fixed between England and the countries included in the sterling area. This "area" includes a group of countries within and outside of the British Empire that are commercially and politically associated with us and have made agreements by which their trade relations with us can be maintained on a basis satisfactory to both parties.

But now there is to be another new era and it is difficult to peer into its possibilities for the London Money Market, owing to uncertainties emerging from decisions arrived at in the course of preliminary discussions which have heralded its approach. From the point of view of this country, the most important of the new features that have been dimly sketched in the international monetary landscape are the conditions attached to the credit of 4,400,000,000 dollars granted by the United States to Britain in July, 1946. These conditions, which were pushed through the British Parliament in the preceding December, were laid down during negotiations carried on between an English mission of which the late Lord Keynes was the most prominent member, working so earnestly to put his country's case that he shortened his life, and representatives of the United States.

In moving the adoption by the House of Commons of the agreement made between the two Governments the Chancellor of the Exchequer, as reported in *The Times* of December 13, 1946, said that it was by no means what we had at first proposed. "In view of the nature and extent of the British contribution to the common cause, and of the fact we had held the pass alone for more than a year when all our European allies had been trodden down into the mud, and while the United States and the Soviet Republics were still neutral, our representatives first proposed at Washington that to enable us to restore the gravely disturbed balance of our economy, gravely disturbed in the common cause of all, we should receive some form of grant-in-aid, or failing that, an interest-free loan."

In answer to these contentions, set out in detail by our representatives, they were told that the American

Congress would never consent to any such agreement. On other points in the agreement also the American spokesmen held their pistol firmly at the head of this impoverished country, obliging its representatives to consent to forms of words in its drafting not at all such as they would have preferred.

Of the total of 4,400,000,000 dollars included in the loan, 650,000,000 dollars represents the final settlement of "lend-lease." It will be remembered that in the early days of the war America provided goods to the belligerents on a "cash and carry" basis—all that she sold to us we had to pay for in cash and bring home in our own ships, or in ships that we could charter. Later on the ingenious device of mutual aid through lend-lease was hit on by President Roosevelt or his advisers. The Mutual Aid agreement embodying it, dated February 23, 1942, provided that the United States would continue to supply to the United Kingdom such defence articles, services and information as the President should allow to be transferred, and the United Kingdom should continue to make a similar contribution to the defence of the United States. When the time came for final settlement, it was to be such as to promote advantageous economic relations between the two countries and the betterment of world-wide economic relations. It should thus include agreed action for the expansion of production, employment, and consumption and for "the elimination of all forms of discriminatory treatment in international commerce and the reduction of tariffs and other trade barriers."

Does the "elimination of all forms of discriminatory treatment" mean that we have to give up Imperial Preference and all the arrangements made between us and countries included in the sterling area?

Mr. L. S. Amery, that stalwart champion of Imperial Preference and protection for British agriculture and other industries, points out in his vigorous and timely work on the *Washington Loan Agreements*, that Mr. Churchill had told the House of Commons on April 1, 1944, that he had received an assurance from President Roosevelt to the effect that "we were no more committed to the abolition of Imperial Preference than the American Government were committed to the abolition of their high protective tariffs"; and Mr. Amery adds a doubt whether the text of this article (No. 7) of the Lend-Lease agreement really commits us to anything. He also argues that the line taken by our representatives at the more recent discussions concerning the loan was a grave mistake; and that if they had produced a strong brief to show how well we could do without a loan if it was not to our liking, instead of a statistical compilation showing how much we had suffered for the common cause, the result of the negotiations would have been very different.

However that may be, the fact remains that the loan agreement has been signed by both parties and that under its terms we are to be granted a credit amounting to some £1,100,000,000, to be drawn on until the end of 1951 and bearing interest at 2 per cent., though no payment of interest or repayment of principal is due until December 31, 1951. The annual interest is to be cancelled in any year in which our exports, visible and invisible (that is, of goods and services), are not enough to pay for our pre-war level of imports. After 1951 the credit is to be repaid in annual instalments, including interest, of just over £35 millions over fifty years.

Small wonder that the Chancellor of the Exchequer

was loudly cheered by the House of Commons when he said that "the great load of debt which we were bringing out of the war is indeed a strange reward for all we in this land did and suffered for the common cause. . . . It is indeed a strange and ironical reward on which historians will make their comment, and, pending that, we have to deal with the situation."

Nevertheless, the terms of the loan, if the loan stood by itself, are certainly generous; but some of the conditions attached to it look as if they will be difficult to carry out. We are obliged by them, within one year after the date of the loan agreement, to make sterling receipts from current transactions of all sterling area countries freely available for current transactions in any currency area without discrimination, with the result that any discrimination arising from the so-called sterling area dollar pool will be entirely removed. In other words, all the advantage that we might have secured by owing debts expressed in our own money, that could only be spent in our own country, or in those bound to us by some form of currency link, are to be sacrificed within a year; and the same thing is to happen whenever we make arrangements for settlements covering the sterling balances accumulated by sterling area and other countries—any sterling balances so released are to be available for current transactions anywhere.

There must be a wide smile on the face of the Muse of History, when she sees America, once the happy home of the protectionist, forcing, as the price of sorely needed accommodation, free trade principles and actions down the starving throat of England, so long the champion of the open door in commerce and finance, when multilateral trade was so useful to our

accepting houses and the bill on London. But it is in fact a very serious matter; for if we are to restore the standard of life in our country, and especially of those who do its hardest and dullest work, we have to work a great increase in its exports. In order to do so, we need every ounce of bargaining power that we can command.

It must be remembered, however, that, under the terms of the agreements made between America and Britain, we are committed only to make mutual concessions—that is, that we can call upon our creditor to open his market to us in so far as we do the like for him. Article VII of the Mutual Aid agreement of February, 1942, specifically referred to in the loan agreement, says that both Governments will continue to discuss arrangements for agreed action for the attainment of its economic objectives. These include agreed action by the United States and Britain, open to participation by all other countries of like mind, directed to the expansion of production, employment, the exchange and consumption of goods, and among other things the reduction of tariffs and other trade barriers.

Then there is the Bretton Woods agreement, which, after many months of discussion in 1944, hatched out plans for an International Monetary Fund and an International Bank for Reconstruction and Development. The Monetary Fund consists of quotas subscribed by all the nations except those that started the late war, who will presumably be allowed to come in later when they have turned over new leaves. The quotas are in proportion to the estimated needs of the subscribing nations and are to be paid as to 25 per cent. either in gold and the balance in the currency of the subscriber, or by a payment of one-tenth of its

net official holdings of gold and United States dollars at the date when the Fund starts business in exchange and the balance in domestic currency. Members of the Fund can acquire the currency of other members in exchange for gold or their own currency. If members of the Fund do not maintain a fairly even balance of payments, with the result that the Fund's supply of their currencies becomes too large or too small, measures will be taken for correcting the position. The quotas assigned to the member nations range from 2,750 million dollars to the United States, 1,300 millions to the United Kingdom, 450 millions to France, 400 millions to India, and 300 millions to Canada, down to half a million to Costa Rica, Liberia and Panama. Each member is to have 250 votes plus one additional for each part of its quota equivalent to 100,000 dollars.

All members will be required to furnish the Fund with such information as it needs for carrying out its objects—a valuable provision if honestly observed. Other good points in the scheme are the evidence that the managers of the Fund will acquire, by the action of the various members, of the state of their trade balances in the widest sense of the phrase; and the mere existence of this world-wide organization should bring home to its minor members the fact that all the world is a market for any goods and services that can be supplied of the right quality at the right price. Its obvious drawbacks are the perhaps necessary complications of detail and the probably slow and clumsy handling of its business by its managers and the committees who are to assist them.

But from the point of view of the early future of the London Money Market, we want to know how it

is to be expected to face the conditions in which it is to work. Apparently, the conversion of sterling into gold, by which it was freed by the fall of the pound, is to be replaced by its conversion into any currency that its holders demand—quite a reasonable arrangement, if it were not for the fact of the enormous sterling debts that we were obliged by the war to incur. As to the date on which this new convertibility is to be enforced, the loan agreement says one year, while Bretton Woods thought five was more reasonable.

In an article entitled " The Consequences " in its issue of December 22, 1945, the *Economist* first regaled us with a picture of what might happen if all went well. " The economic consequences," it said, " depend entirely upon whether or not British exports can be expanded by the requisite amount by the time the line of credit in America is exhausted. If they can, then all will be well. The country will be able to pay its way; there will be no difficulty in making the proceeds of British imports freely convertible into any currency in the world " (that is, allowing any outside trader who sells goods or services to us to turn the money that he earns into any other), " the massive debts originating in the war can be slowly amortized; London, fully solvent, can recover its function as a world banking centre. . . . It is true that, even in these circumstances, world trade can still be expected to be very erratic and unstable. . . . But the United Kingdom will not suffer unduly in the bad years and there will be some good years."

Not a very cheering prospect if this is the best that can be said of the future, to which we have been condemned by our present and recent Governments and their expert advisers; and if the export target is not

reached, then the prospect is grim; for then the only recourse will be to cut imports down to the level that can "be paid for." Whether we should be able to do so by higher tariffs is doubtful, for we are pledged to enter into "arrangements for substantial reductions of tariffs"; but quotas are permissible, though one of the conditions attached to them is that "they should not discriminate among sources of supply in respect of any important product." This clearly means, as the *Economist* points out, "that we should have to cut down our imports from countries that would be perfectly content with payment in sterling equally with those from countries that demand payment in dollars. . . . What is more, since the countries that would be content with payment in sterling are, on the whole, our best export markets, this 'non-discriminating' cut in our imports could hardly fail to reduce our exports still further."

Sir Hubert Henderson, a distinguished Cambridge economist now working at Oxford, began a letter printed in *The Times* of December 12, 1945, with the blunt statement that "the financial agreement with the United States is for a loan upon conditions which are calculated to ensure default. . . . We need every aid which deliberate arrangement and planning can supply. None the less, we have promised to eschew such aids and to leave everything, or almost everything, to the chances of international competition."

But there is no need to give further quotations by English authorities concerning the difficulties that lie ahead of us in trying to fulfil the conditions attached to the American loan if they are interpreted literally. For Mr. Amery, in the book already cited, gives us a tip, straight from the horse's mouth, by quoting a

report on " The United States in the World Economy," issued in 1943 by the United States Department of Commerce, and reprinted in 1944 by our own Stationery Office (its reprint being out of print when asked for in June, 1946). This Department of Commerce report practically advises us to do everything that the loan agreement seems to forbid us to do. It tells the story of the post-war boom in America and its collapse in 1920, followed by general recovery stimulated by " an immense volume of American lending," but checked and destroyed later by the attraction of the domestic boom which withdrew American interest from other markets, an almost complete suspension of the immense American expenditure on tourist traffic and of home remittances by European workers in America, and a sharp upward revision of the American tariff in 1930 by the Hawley-Smoot tariff which " only aggravated the disequilibrium. The measure of the reversal of policy is shown by a graph giving the total excess of dollars supplied by the United States through new investment abroad and purchases of goods and services over debt service payments to the United States as 6,500 million dollars in 1929 and 1,500 millions in 1932, a shrinkage of 77 per cent."

Against this shattering blow delivered by the richest country in the world, the rest of us took measures, by abandoning (in our case after a hard struggle to maintain it) the gold standard, raising tariffs and establishing exchange controls and making mutual arrangements, which brought the sterling area into being. And we did so with such effect that, as the United States Department of Commerce tells us, " not only was recovery rapid and far-reaching in the countries which had recourse to these measures of total or partial

isolation, but it was more rapid, more complete and steadier than in the United States." The report finally points out that "a world economic structure organized on the basis of equal treatment and with large scope for free enterprise cannot be maintained in the face of such reductions in the supply of dollars as have occurred in our international transactions in the past. Unless the supply of dollars" (by American purchases of foreign goods and services) "is more adequate to meet the requirements of other countries, they will assuredly insist on their right to exercise a close selective control over the use of the amounts available and to promote more intensive relations with third countries under preferential trading arrangements."

Thus supported by the United States Department of Commerce we may perhaps hope that when it comes to translating the vague terms of the loan agreement into definite expressions, which will perhaps be done at an International Trade Conference to be held, perhaps, next spring, we may find that American representatives, with an eye on the American public's traditional love of the tariffs behind which they have built up so much prosperity, may be unwilling to insist too closely on the loan agreement terms that restrict our actions, as long as we do not insist too vigorously on the tariff concessions to which the United States are committed by it. If we are given more time, and more elbow-room in dealing with the advantages that the Empire and the sterling area have given us, we may yet get round this awkward corner. The generous help that we have received during and since the war from the British Dominions, particularly from Canada, is of good augury for the future. When transport facilities are increased and improved, tourist

visitors in shoals should bring a flood of their currencies to be spent here; and it may be hoped that our hotels and lodging-houses will do their best to welcome them.

But whatever the future may have in store for us, one thing is obviously and painfully certain. We have to work as hard as ever we can and to stint ourselves of all comforts except such as keep us fit for hard work. This necessity is imposed on us by the fact that during the war we devoted our whole energy to the war effort, allowing our equipment for the provision of all unnecessary goods and services to be converted to war purposes, if suitable, or, if not, to go to waste.

This means that a great work of reconstruction has to be done before we are in a position to produce those amenities that we formerly enjoyed, or to produce goods and services to sell abroad in exchange for the luxuries that made life more agreeable than it is in these days—if we want wines from France and tobacco from Virginia or Rhodesia on the scale that we used to enjoy, we have to reconstruct the industries that once turned out boots or clothes or whatever it was that we sold abroad to pay for such amenities. Shall we ever be able to restore our oversea sales of coal, that were once so profitable?

And we also have to make good, if we want to live on the same scale of luxury as before, the swallowing up in the sink of war of the oversea investments, the income from which we took in the form of goods for consumption.

Is our industry in good shape for this effort? Surely we are justified in hoping that when the need is brought home to all its organizers and workers, it will rise to the occasion as well as it rose to the needs of our fight for existence. We have expressed our determination

to create opportunities of a healthier and happier life for what are called the lower orders of society. This is in some ways a nobler ambition than self-preservation, which is a merely animal instinct, while desire for well-spread betterment implies certain generous sympathies.

In spite of weaknesses here and there, due to natural reaction after the war effort, there are evidences that we are ready to apply the lessons that the war taught us. The long delay on the part of Congress in ratifying the credit that we have been expecting, has led to our supplying ourselves with items of machine-tool equipment that have hitherto only been procured from the United States. "Before the war," said a recent paragraph, "certain die-sinking machines, gear-cutting plant and, particularly, heavy presses could not be obtained from British makers. Already some leeway in correcting this has been made and more will be done."

Controls and priorities, on which so much complaint is heard, will have to be suffered until we are well round the corner; but already their advantage is occasionally acknowledged. At the recent meeting of the Bradford Dyers' Association, Mr. James Ewing, its chairman, said that he would like to say a word in praise of the Board of Trade utility schemes as applied to cotton, rayon and wool fabrics. "Apart from setting an excellent standard of quality, which is in the interest of the consumer, the system has benefited producers considerably by affording bulk orders and a concentration of types; both factors of immense value in reducing manufacturing costs and prices. The success of the scheme could not have been achieved without the co-operation of distributors and producers; the need for this co-operation will continue long after the need for austerity has passed."

Controls, well exercised, thus can give effective help both to enterprise and to the consuming public; but it must be hoped that in its eagerness for control the Government will remember that in former days the position of London as centre of world finance was immensely helped by the existence of the commodity markets, with cash and future transactions in cotton, metals, grain, rubber, etc. Critics say that our present rulers do not understand their working but believe them to be nothing but vehicles for unrestrained speculation; and cherish a preference for bulk buying, the cost of which, carried out by officials, is not disclosed.

That London should ever recover her position as the leader of international finance can hardly be expected, now that two outbursts of madness in Europe have brought the immense industrial and financial strength of America into the place that it was bound to occupy sooner or later. But London, like British industry, can win its way with quality of service. Even in its present weakened condition, its old tradition of reasonable consideration for the position of its clients, and of refraining from squeezing the last ounce of profit out of every bargain, is bearing fruit by securing custom for it. If the future is uncertain, it has its bright aspect, as long as all ranks of producers will work hard and well, and all ranks of consumers will restrain their demand for goods and services, home-made or imported.

Recent events have certainly given the country plenty of practical lessons in applied economics, and hammered home the obvious fact that it can only live on what it makes or grows or on the interest received from investments abroad made by the sale of the output of former generations. And though our

financial mentors in the press, who put so much more work and intelligence into their job than was supplied by my comrades and myself when I was an active member of the craft, have very properly been rubbing it into our rulers that the "sands are running out" and that we are headed for disaster if they do not quicken the pace of recovery, there is surely plenty of reason to hope that favourable features in the financial landscape may enable us to come round this corner and make our way into a more attractive patch of scenery.

Mr. Oscar Hobson, City Editor of the *News Chronicle*, pointed out in an article on February 18, 1947, that the present fuel crisis was due to the fact that for the past five years Britain had been consuming 102 tons of coal for every 100 produced and this 2 per cent. deficiency of production was the cause of all the mischief. It therefore ought, he thought, not be too difficult to escape from the present crisis and build up stocks to the safety level by next winter. But that would not save us from national bankruptcy and the collapse of our standard of living if we could not bring our balance of payments (our account with other countries on sales and purchases of goods and services) into equilibrium by the time when our dollar credit has expired. For that reason our present coal output must be greatly and quickly increased. It is now, continued Mr. Hobson, practically a million tons a week, 50,000,000 tons a year, or 22 per cent., less than in 1937.

For this decline there were three causes—a drop in the number of men employed in the mines, voluntary absenteeism, and decrease in output per man, due to a number of factors, such as transport delays, scarcity of materials, plant breakdowns, and so on.

All these drawbacks may surely be remedied. To mend the lack of men there are Poles now here and numbers of "displaced persons" on the Continent. Their addition to our working staff might be in some ways a repetition of the very valuable improvement in our productive output that we secured in the time of Queen Elizabeth, thanks to the influx of Huguenots from France after the Bartholomew massacre and from the Netherlands owing to the anti-Protestant activities of the Spanish authorities. They brought trades and crafts with them, which laid the foundations of industries, backed by protective measures and official encouragement. Such immigrants as are available now might be expected to improve the standard of regularity in work, and the recent action of the mining and railway workers in being ready to increase the coal output by working on Sunday shows that an example of this kind might be fruitful.

But if it proves that the Government is so afraid of its Labour supporters that it dare not encourage immigration of foreign labour, then there is another hopeful suggestion—the substitution of oil for coal as the driving power for industry.

Possibilities of this policy were set out in a letter in *The Times* of February 15, 1947, from Mr. Usborne, managing director of the Nu-way Heating Plants of Birmingham. He stated that the coal-to-oil conversion was unostentatiously started last autumn, and that by it ten million tons of coal per annum can be saved in the next eighteen months, but only if certain action is taken immediately. At present firms are reluctant to convert their furnaces to oil, arguing that when this crisis is past coal is likely to fall, while oil may be dearer or its sale restricted. Mr. Usborne is assured

that this will not be so, but contends that the present difference between the prices of coal and oil should be underwritten for at least three years with a guarantee that oil will be made available to all users for the same period; he states that he knows that oil is abundantly available from the sterling area. As to the difficulty of getting oil-burning equipment, speaking for his own firm Mr. Usborne states that it could treble its production almost immediately; its output when he wrote was five times the figure of a year before and could be increased a further 200 per cent. if orders came in faster.

Apart from technical hopes and possibilities, certain broad facts warrant confidence in our country's recuperative power. Both the wars which have devastated civilization have at the same time enormously promoted productive power in all countries which possessed any and created it in some which had none. Britain has long been the chief external market for this output, and much of it will have to be sold to us on terms that we can afford to pay if the exporting countries are to maintain their standard of living. There are some advantages in the position of debtor; its creditors have to take care of it so as to help it to meet its charges. Again, the wars have shown us that women are well able to do many things that were once considered to be fit only for male effort; so we have here reserves that can be drawn on to fill our cupboards. Our agriculture can do much more for us if it can be guaranteed a fair living and helped with capital to secure it. And improved education should discover stores of intelligence among the classes that have hitherto had little chance of developing it. What is wanted is that the Govern-

ment should cease to exhort and turn its mind to devising incentives, such as bonus on increased results wherever possible, and encouragement to industry to earn profits and put them into equipment." At the end of a debate on a "white paper" setting forth the statistical position of the country, the Prime Minister said that in some quarters it had been taken as a prophecy of disaster. "It was not; it was a challenge to everyone. The Government was asking for the effort of the whole country, industrialists, Government and every one." (*The Times*, March 13, 1947.) To aid its customers, official and private, to meet this challenge, the Money Market, with its fine traditions and unrivalled experience and adaptability, may be trusted to furnish such funds as can be used to good purpose.

In the meantime, another American surprise has made confusion more confounded in the international monetary future. It was recorded in the *News Chronicle* of March 10, 1947, that the President, under pressure from Republican senators, had made an executive order calling for the insertion of "escape clauses" into all commercial treaties to be negotiated under the Reciprocal Trades Act, reserving the right to the United States to withdraw or modify any tariff concession "if it is found that any article is being imported in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers of like or similar articles." This provision evidently makes any tariff reductions by the United States practically worthless, since they are liable to withdrawal or modification at any time, if American industry complains of foreign competition as hurtful to itself.

INDEX

ACCEPTANCE, 30, 31, 38, 48, 56, 130 *et seq.*
Accepting Houses, 38, 130 *et seq.*
and Bank of England, 134, 136
Amenities, as exports, 153
America as World Creditor, 73 *et seq.*, 270 *et seq.*
depreciates currency, 228
panics in, 66, 76, 77
raises gold scare, 260
American banks, 70, 73, 76 *et seq.*, 94, 274
American loan to England, 298, 300
Amery, Mr. L. S., on, 302 *et seq.*
Anderson, Dr., on gold, 264
Argentine dollar, 149
Art treasures, as exports, 153
Athenians, 13

BACKHOUSE, 85
Bagehot, 170, 173, 186
Balance-sheet, 48, 198
Balance of indebtedness, 151 *et seq.*
Balance of trade, 157 *et seq.*
"unfavourable," meaning of, 151, 157
—— cannot be afforded by debtor country, 157
Balfour Committee and long credits, 109
Bank Act of 1844, 21, 24, 167, 169, 199, 244
Bankers, evolved from goldsmiths and bullion dealers, 18
Banking facilities, as exports, 153
Bank for International Settlements, 264
Bank of England, 162 *et seq.*
attempt to put silver behind its notes, 206
Banking Department, 207
bankers' bank, 169
bankers' balance with, 169, 188, 210
borrowed to make its rate effective, 188
branches of, 182
British Government's bank, 163
capital stock, 208
cash at, basis of credit, 121, 167, 168, 174
Committee of Treasury, 178
control of the market by, 191 *et seq.*
credit with, regarded as cash, 121, 167, 168, 174

Bank of England, *continued*—
Directors of, 134, 176, 179
discounts at market rate, 183
Discounts and Advances, 213 *et seq.*
external appearance of, 175, 179
foundation of, 163
functions of, summarized, 173, 174
Government debt, 203
Government securities held by, 205, 212
Governor of, 180, 195
high proportion of cash held by, 170, 174
Issue Department, 199 *et seq.*
keeper of the gold reserve, 169, 172, 186
lays embargo on foreign loans, 195
monopoly of, 21, 91, 164, 166
nation's bank, 163
nationalization of, 292
notes of. *See* BANK-NOTE.
official rate of. *See* BANK RATE.
open market policy, 187, 188, 192, 215
organization of, 176 *et seq.*
Other Accounts, 211
Other Deposits, with, 208, 210 *et seq.*
—— subdivision of, 210
Other securities, held by, 207, 213
—— subdivided, 213
Bank of England, *continued*—
personal touch with market, 195
price of advances by, 123
proportion of cash to liabilities, 170, 174, 211
provider of emergency currency, 165
—— credit, 165, 168
Public Deposits with, 209 *et seq.*
reserve, 203, 216 *et seq.*
Rest, 208, 209
return, 198 *et seq.*
seven-day and other bills, 211
Bank-notes, 17 *et seq.*
Bank of England's, 7, 21, 22, 167, 199 *et seq.*
abandoned, 23, 242
basis of credit, 44
convertibility of, 22
fiduciary, 22, 201, 204 *et seq.*, 218, 244
gold as basis of, 207
Government debt as basis of, 203
legal tender, 27
silver as basis of, 207
Bank of France. *See* FRANCE.
Bank Rate, 182 *et seq.*
connecting link with market rate, 99, 220
disconnection from market rate, 184
" effective," 182
effect of rise in, 239
Banks, American, 70, 73, 76 *et seq.*, 94
—— Central, 183

Banks, *continued*—
Colonial, 137
English, 82 *et seq.*
acceptances of, 49, 101, 135 *et seq.*
advances of, 111 *et seq.*
amalgamations by, 89, 91, 107, 220
balance-sheet, 48
balances of, at the Bank of England, 169, 188, 210
branch offices of, 91, 92
cash reserve of, 64, 88, 221
confidence of public in, 62, 66, 254
current accounts with, 49, 95
debt of, to the public created by loans, 50 *et seq.*
dependant on the public's confidence, 62, 66
deposit accounts with, 49, 50, 60
discounters of bills, 99, 100
failures among, 84
growth of business in exchange, 94, 106
joint stock, 86, 91
loans to bill-brokers, 95 *et seq.*, 116
loans by, to the Stock Exchange, 101 *et seq.*, 127
publication of figures by, 87 *et seq.*, 111
regulate the market rate of discount, 99
Banks, English, *continued*—
"window-dressing" by, 89, 90, 221
Foreign, 137
Indian, 137
Barclay & Co., 91
Barter, 8
Bill of exchange, 29 *et seq.*, 141
acceptance of, 31, 41
anticipatory, 39, 155
antiquity of, 30, 31
as an investment, 36
contrasted with mortgage, 37
distinguished from cheque, 29, 30
finance, 39, 42
"House," 43
imports and exports of, 160
legal definition of, 32
"pig on pork," 43
space, an element in, 32
specimen of, 40, 42
Quixote's bill of ass-colts, 32
time, an element in, 31, 32
Bill brokers, 95, 97, 115 *et seq.*, 188, 215
Bimetallism, 16, 206
Bonds, drawn, as exports, 157
sales of, as factor in exchange, 158
Bradford Dyers on advantage of Controls, 311
Branches, banking by, 91 *et seq.*
Brazil, effect of loan by on exchange, 157
Bretton Woods, 304
Bronze coins, 7, 16

Gold, *continued*—
sent abroad by low discount rate, 160
settles international trade balance, 150
standard, 16, 22, 80, 172, 207, 220 *et seq.*, 243, 275
statue of Athene, overlaid with, 13
statutory price of, 12, 23
steadiness of, in value, 13
universal acceptability of, 13
value of, 12, 15
Goldsmiths, early bankers, 18
Gold Standard Act, 22
Government, as factor in money market, 124, 126, 193, 209, 212
Government Debt to Bank of England, basis of note issue, 203
Government securities, in Bank return, 203, 212
Gresham's Law, 10, 11, 15

HALL, Prof., 250
Hambro, Mr., 258
Harvey, Sir E. M., on central banks, 183
Henderson, Sir H., 307
"Hidden hand," 195
Hitler election, 80, 272
Hobson, Mr., on coal position, 313
Homer, 9
Hoover, Mr., 80
"Hot Money," 72, 256, 257, 266
Hyde, Mr., on window-dressing, 90

INDIA, sells gold, 246
Indian banks, 137
Industrial and Commercial Finance Corporation, 295
Industry and Credit, 109, 139, 221, 239
Insurance facilities as exports, 153
Interest, rate of, 3
stability desirable in, 239
Interest coupons, as exports, 152
International Bank for Reconstruction, 304
International Monetary Fund, 304
International Settlements, Bank for, 264
International Trade Conference, 309
Invisible Exports, 152
Italy, economic progress of, 158

JOINT-STOCK banking, 86, 91
discount houses, 117

KEYNES, Mr., 222, 260, 300
Kine, circulation, 9
standard of value, 9
"Kites," 33

LABOUR and the Nation, on credit, 222
Legal tender, 15, 26, 27, 64
Leake, Mr. P. D., on Bank rate, 239
Lend-lease, 301
Loan issue, influence on exchange, 157
"Lombard Street," Bagehot's, 170, 173, 186

London, in international finance, 69 *et seq.*, 254, 264
London and Westminster Bank, 91

MABERLY PHILLIPS, quoted, 95, 96
May Committee, 226, 275
McKenna, Mr., and Midland Bank advances, 107
Ditto on current accounts, 112
Market rate of Discount, 118
Midland Bank's *Review*, 209
"special advances," 296
Money, book-keeping credits, 46
cost of production of, 190
different senses of, 1
leather, 9
market, 3, 4
quantity theory of, 234 *et seq.*
some day, 4
somewhere else, 4
Special City meaning of, 97
stability in price of, desirable, 239
Mutual Aid Agreement, 301
Mutual Indebtedness, basis of currency, 18 *et seq.*, 46 *et seq.*

NATIONAL SAVINGS, 294
Naval "Mutiny," 279
Norman, Mr., 180
"Not negotiable," 26
Notes, Bank, 18 *et seq.* *See* BANK OF ENGLAND.
cash, backing of, 21
goldsmiths', 18

OCTOPUSES, banking, 107
Old Testament, 8
"Open market policy," 187, 192, 215, 241, 288
Other Deposits, 210
Securities, 213
Ox, as currency, 9
standard of value, 9

PANIC, effect of, 63, 66
Paper cash, 17 *et seq.*
Paris, 147 *et seq.*
Pecunia, 8
Pleasure, as export, 153
Prices, fluctuations in, 229 *et seq.*
stability in, desirable, 234
Public deposits, 209 *et seq.*
Publicity in banking, 61, 87, 111
Punch, on the Bank, 223

QUANTITY Theory of Money, 234 *et seq.*
Quixote, draws a bill, 32

RATE of interest, 4
—— discount, and exchanges, 160, 185
Regulation of money market essential, 161, 190
Reserve, Bank of England's, 203, 216
Rest. *See* BANK OF ENGLAND.
Rist, M., 227, 276, 277
Roosevelt, Mr., 77, 260, 282
Running broker, 115

SECOND of exchange, 42

Securities, movements of, as factor in exchange, 156 *et seq*
Seddon, Mr., 152
Seven-day and other bills, 211
Silver, 17
 as basis of Bank of England notes, 206
 coins mere tokens, 16
 currency and exchange, 150
 fixed ratio with gold, 15, 206
 legal tender up to £2, 16
Smith, Adam, 86, 105
Snowden, Lord, 276
Sovereign, advantages of, 10
 replaced by £1 notes, 7, 14
Speculation, 101, 259
Stability of prices desirable, 14, 230
Stamp, Lord, 275
"Standstill," 226
Sterling area, 299
Stock exchange and the money market, 127
 bankers' loans to, 101 *et seq.*
 securities, limited realizability of, 103
Strong, Mr. Benjamin, 180, 238
Sunday Times, 290

TARIFFS, 153, 181, 228, 316
Tariff Advisory Committee, 281
Tax-payments, effect on money market, 126, 193, 210
Times, 207, 262, 296
Titles, as exports, 153
Trade, and the money market, 107, 109, 125, 222, 239
Trade, balance of, 152 *et seq.*
Treasury and market, 126, 193, 212, 249, 250
Treasury bills, 114, 161, 193, 206, 218, 246
Treasury Deposit Receipts, 291
Treasury notes, 7, 21, 198, 202

U.S. DEPARTMENT of Commerce report on U.S. in World Economy, 308
Usborne, Mr., on oil for coal, 314

WABASH, 69
Ward, Miss, M.P., 110
Weather and the money market, 125, 126
Wheat, more variable in value than gold, 12
World Money Market, 68 *et seq.*